90-659 (1)

No. 90-______

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

KEITH R. GOLLUST, PAUL E. TIERNEY, JR., AUGUSTUS K. OLIVER, GOLLUST, TIERNEY AND OLIVER, GOLLUST & TIERNEY, INC., CONISTON PARTNERS, CONISTON INSTITUTIONAL INVESTORS, BAKER STREET PARTNERS, WJB ASSOCIATES and HELSTON INVESTMENT INC.,

Petitioners,

—v.—

IRA L. MENDELL, in behalf of Viacom Inc. and, alternatively, Viacom International Inc., VIACOM INC. and VIACOM INTERNATIONAL INC.,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTION PRESENTED

Whether the court below erred in ruling that the phrase in Section 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b), granting standing to bring an action thereunder to "the owner of any security of the issuer" can be interpreted to include a "former owner" of such securities, and thereby holding that Respondent could maintain an action under Section 16(b) on behalf of an issuer of securities after he had ceased to own any of its securities?

PARTIES TO THE PROCEEDING

All parties to this proceeding are identified in the caption.* In addition to these parties, the Securities and Exchange Commission participated in the proceedings before the United States Court of Appeals for the Second Circuit below as *amicus curiae*.

* The following information is provided pursuant to Rule 29.1 of this Court: Petitioner Gollust & Tierney, Inc. is owned by Keith R. Gollust and Paul E. Tierney, Jr., and has no subsidiaries; Petitioner Helston Investment Inc. is wholly owned by Coniston North Atlantic International Corp. and has no subsidiaries.

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Petitioners Keith R. Gollust, Paul E. Tierney, Jr., Augustus K. Oliver, Gollust, Tierney and Oliver, Gollust & Tierney, Inc., Coniston Partners, Coniston Institutional Investors, Baker Street Partners, WJB Associates and Helston Investment Inc. ("Petitioners") respectfully pray that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered in this proceeding on July 25, 1990.

OPINIONS BELOW

The opinion of the Court of Appeals for the Second Circuit (1a[1]) is reported at 909 F.2d 724 (2d Cir. 1990). The Opinion and Order of the District Court for the Southern District of New York granting summary judgment in favor of Petitioners (30a) is reported unofficially at [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,086 (S.D.N.Y. Nov. 8, 1988). The Final Judgment of the District Court (34a) is unreported. The Opinion and Order of the District Court denying Respondent's motion pursuant to Fed. R. Civ. P. 60(b) for relief from the final judgment (35a) is reported unofficially at [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,477 (S.D.N.Y. May 23, 1989).

JURISDICTION

The judgment of the Court of Appeals for the Second Circuit was entered on July 25, 1990. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTE INVOLVED

This case involves Section 16(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78p(b), which provides:

> (b) For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection.

1 References to the Appendix hereto are cited "_____a".

15 U.S.C. § 78p(b). The phrase "such beneficial owner, director, or officer" in Section 16(b) refers to Section 16(a) of the Exchange Act, 15 U.S.C. § 78p(a), which imposes certain reporting obligations on "[e]very person who is directly or indirectly the beneficial owner of more than 10 per centum of any class of any equity security (other than an exempted security) which is registered pursuant to [Section 12 of the Exchange Act, 15 U.S.C. § 78*l*], or who is a director or an officer of the issuer of such security . . . ."

STATEMENT OF THE CASE

Ira L. Mendell, in behalf of Viacom Inc. and, alternatively, Viacom International Inc. ("Respondent"), filed his original complaint herein in January 1987, alleging that he was then a holder of common stock of Viacom International Inc. ("International"), a company whose shares were listed on the New York Stock Exchange and registered under Section 12 of the Exchange Act, 15 U.S.C. § 78*l*, and that he

was entitled to assert a Section 16(b) claim on behalf of International against Petitioners arising out of their purchases and sales of International stock in 1986.

In June 1987, International was acquired by Arsenal Holdings, Inc. (now named Viacom Inc. and referred to herein as "Viacom") through a merger with a subsidiary of Viacom pursuant to which International became a wholly owned subsidiary of Viacom and the shareholders of International received a combination of cash and Viacom securities in exchange for their shares of International. As a consequence, Respondent ceased to be a shareholder of International, becoming instead a security holder of its new parent corporation, Viacom.

Respondent's amended complaint, served in February 1988 (the "Complaint"), alleged that as a result of the merger, Respondent was now a holder of stock of Viacom. Complaint ¶ 9; 40a. The Complaint also alleged that by reason of the merger, Viacom became "the issuer within the meaning of Section 16(b)." *Id.* at ¶ 20; 43a. Finally, realizing that he may be held to lack standing, Respondent alleged alternatively that his action was brought as a "double-derivative" lawsuit on behalf of International. *Id.* at ¶ 24; 44a.

Petitioners moved for summary judgment in May 1988, arguing that Respondent did not have standing to sue because he was no longer a holder of securities of International—the issuer on whose behalf the suit was brought—and that Respondent could not escape his lack of standing by asserting a "double-derivative" action.

A. The District Court's Standing Decision

On November 8, 1988, the District Court, relying principally on the Second Circuit's decision in *Untermeyer v. Valhi, Inc.*, 841 F.2d 25 (2d Cir.) (per curiam), *cert. denied*, 488 U.S. 868 (1988), issued an Opinion and Order holding that "[b]ecause, as a matter of law, plaintiff does not have standing to prosecute his § 16(b) claim against defendants, their motion [for summary judgment] is granted." *Mendell v.*

Gollust, [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,086, at 91,086 (S.D.N.Y. Nov. 8, 1988); 31a.

As an initial matter, the District Court noted that Section 16(b) actions may be prosecuted "only by the issuer itself or the holders of its securities," *id.* at 91,086; 32a, and because Respondent no longer owned any International securities, he had no standing to maintain a Section 16(b) action on behalf of International, *id.* at 91,087; 33a.

The District Court then turned to whether Respondent had standing to sue as a security holder of the new parent corporation of the issuer. Noting that International remained a viable corporate entity, and that it had a shareholder—Viacom—the District Court held that the explicit language of Section 16(b) limited the right to sue to either International or Viacom. *Id.* at 91,087; 33a. Respondent, being neither, therefore lacked standing to maintain his action under Section 16(b). *Id.*[2]

2 The District Court also rejected Respondent's attempt to circumvent the express standing requirements of Section 16(b) by labelling the lawsuit a "double-derivative" action, stating that "shareholders of a shareholder are not the issuer or the owners of the issuer's securities, and therefore, by the statute's own terms, they are not entitled to sue under § 16(b)." *Id.* at 91,087; 33a.

After filing his first notice of appeal from the District Court's November 8, 1988 Opinion and Order, but before any action was taken on Respondent's appeal, in January 1989, Respondent decided on a new tactic: to regain standing to sue, he went into the market and purchased a $1000 bond of International that was part of an issue that had been offered to the public prior to the District Court's November 8, 1988 Opinion and Order. Respondent advised the Second Circuit of his new "status" as a security holder of International and of his intention to make a motion to vacate the District Court's judgment, and the parties thereafter stipulated to withdraw Respondent's appeal from active consideration by the Second Circuit in order to allow Respondent to make his motion pursuant to Fed. R. Civ. P. 60(b).

On May 23, 1989, the District Court denied Respondent's Rule 60(b) motion stating that his "after-the-fact stratagem devised following an adverse opinion" was not a sufficient basis, under Rule 60(b)(6), to vacate the District Court's prior order and judgment. *Mendell v.*

B. The Court of Appeals' Decision

After oral argument was held before the Court of Appeals on November 21, 1989, that court on November 28, 1989 requested the Securities and Exchange Commission (the "Commission") to submit an *amicus curiae* brief setting forth its views on Respondent's standing under Section 16(b). *Mendell v. Gollust*, 909 F.2d 724, 726 (2d Cir. 1990); 6a. The Commission responded by submitting a brief in which it acknowledged that decisions of the other Courts of Appeals (as well as previous cases from the Second Circuit itself) had uniformly denied standing to plaintiffs in situations similar to that of the Respondent here, but nevertheless argued in favor of Respondent's standing principally in order to vindicate what it viewed as the "broad remedial purpose" of Section 16(b).

On July 25, 1990, the Court of Appeals panel, by a 2-1 decision, reversed the District Court's November 9, 1988 ruling granting Petitioners summary judgment based on Respondent's lack of standing.[3]

The opinion of the majority made clear that the focal point of its decision was not the actual language of the standing provisions of Section 16(b) at issue here, but what it perceived to be the broad remedial purposes underlying Section 16(b). The opinion began by discussing the legislative history

Gollust, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,477, at 93,051 (S.D.N.Y. May 23, 1989); 38a. Further, in response to Respondent's plea that he did not think of purchasing the International bond sooner, the District Court stated that "[c]ounsel's ignorance of the law cannot form the basis for an order under Fed. R. Civ. P. 60(b)(1)." *Id.* at 93,050; 37a. Respondent thereupon filed a second notice of appeal challenging the District Court's denial of his Rule 60(b) motion.

3 The Court of Appeals did not reach the question of the District Court's rejection of Respondent's standing argument based upon an alleged "double derivative" action, 909 F.2d at 731; 18a, but affirmed the District Court's denial of Respondent's Rule 60(b) motion (*see* note 2 *supra*), *id.* at 731-32; 18a-19a. Neither of these issues are raised or addressed in this Petition.

of Section 16(b) and the purposes of the statute, 909 F.2d at 726-27; 7a-8a, and reviewed prior case law involving the construction of Section 16(b) purportedly indicating that where Section 16(b)'s terms are susceptible of differing constructions, it should be construed broadly. *Id.* at 727-28; 8a-10a.

Turning to the standing requirements of Section 16(b), the majority stated that "the question of whether a plaintiff has standing to bring suit is, in part, determined by whether the policy behind the statute is best served by allowing the claim." *Id.* at 729; 12a. Although the majority acknowledged that "the amount or value of a [Section 16(b)] plaintiff's holdings or his motives for bringing suit are not relevant" to the question of standing, *id.* at 729; 12a, it also reasoned that, in cases such as this, standing could be determined on the basis of an assessment of the likelihood that the statute would be enforced by the available plaintiffs, *id.* at 729; 13a (in cases where original issuer survives merger as wholly owned subsidiary of a new parent corporation, "[a]s a practical matter it is unrealistic to believe that the issuing corporation will bring an action against itself or its insiders.").

Only after concluding that, as a matter of policy, plaintiffs such as the Respondent here should be granted standing in Section 16(b) cases did the majority actually address the contention that the statutory language did not support this conclusion. *Id.* at 730-31; 15a-16a. In what amounted to nothing more than judicial redrafting of legislation, the majority stated that, because the reference to the "owner of any security of the issuer" in Section 16(b) was not modified by the word "current", the statute did not specifically bar the maintenance of Section 16(b) suits by "former" owners of the issuer's securities. *Id.* at 730; 15a. The majority also attempted to distinguish earlier decisions from the Second, Seventh and Ninth Circuits that had uniformly held that a Section 16(b) plaintiff must remain a security holder of the issuer throughout the litigation, and that if a security holder of the issuer ceases to own such securities, he loses his standing to continue the action. *Id.* at 730-31; 15a-17a. Although its decision is plainly inconsistent with those earlier decisions,

the majority sought to distinguish them on the ground that this case presents a "novel situation" in that Respondent's shares of the issuer corporation were exchanged for securities of its new parent corporation and therefore the issuer's former shareholders had a "continuing interest in maintaining suit in behalf of the issuer." *Id.* at 730-31; 16a-17a.

Finally, although nothing in the record below suggested that the acquisition of International by Viacom (a previously unrelated third party) was in any way related to this lawsuit, the majority stated that its decision had the laudable effect of precluding corporate reorganizations that were effected for the express purpose of avoiding Section 16(b) liability. *Id.* at 731; 17a.

In a thorough dissenting opinion, Senior District Judge Milton Pollack (sitting by designation) noted that "[t]he majority's ruling departs from the unequivocal terms of the statute to be administered and from the prior case law of this Court applying the statute, and it conflicts with rulings of the other Circuits which have addressed the requirements of the statute." *Id.* at 732; 20a. The dissent noted that Respondent "no longer satisfies the plain statutory requirement—ownership of securities of the issuer", *id.* at 732; 21a, and that the decision of the District Court was consistent with prior case law of the Second Circuit and with rulings from the Seventh and Ninth Circuits—the only other circuits to address the issue—as well as with "traditional rulings in other contexts" holding that continuing ownership of securities of the issuer is required in order to present a justiciable case or controversy. *Id.* at 733; 22a-23a.

The dissent also noted that the Commission itself recognizes "that qualifying former shareholders to sue, either judicially or by rule-making, is a marked departure from the pre-existing jurisprudence under § 16(b)." *Id.* at 735; 26a-27a. The dissent observed that "Congress simply has not delegated to the courts the authority to qualify a 'former' owner as an 'owner of any security of the issuer' ", *id.* at 735; 27a, and "[t]here is simply no indication in any of the legislative

history of § 16(b) that the plain meaning of the words 'owner of any security of the issuer' was meant to include or even could include one who is no longer the owner of any security of the issuer," *id.* at 735; 28a. Accordingly, the dissent urged the court to "reject [Respondent's] invitation to draft 'judicial legislation' to grant him standing." *Id.* at 736; 29a (citation omitted).

REASONS FOR GRANTING THE WRIT

I. THE DECISION OF THE COURT OF APPEALS RAISES SIGNIFICANT QUESTIONS CONCERNING THE CRITICAL THRESHOLD ISSUE OF STANDING UNDER SECTION 16(b) OF THE EXCHANGE ACT THAT HAVE NOT PREVIOUSLY BEEN ADDRESSED BY THIS COURT

The specific issue before the Court of Appeals was whether, under Section 16(b), an owner of a security of the issuer has standing to continue a Section 16(b) action once he no longer owns any security of the issuer. The broader issue presented in this case is whether the federal courts have the power to expand upon the unambiguous language of Section 16(b) to accord standing to sue to one who does not meet the statutory requirement in order to further what those courts perceive to be the remedial purposes of the statute. The Court of Appeals majority below, in an unprecedented opinion, answered both questions in the affirmative.

This Court has not addressed any question of interpretation of Section 16(b) in fourteen years, since *Foremost-McKesson, Inc. v. Provident Sec. Co.*, 423 U.S. 232 (1976), and has never addressed the important threshold question of the circumstances, if any, under which a plaintiff who does not constitute "the issuer, or . . . the owner of any security of the issuer" has standing to commence and maintain an action under Section 16(b). In other Section 16(b) cases, however, this Court has consistently required that, in interpreting the carefully circumscribed provisions of this unique strict

liability statute, courts limit liability to situations that are plainly and unambiguously covered by the language of the statute. In finding that, under the circumstances of this case, Respondent has standing to maintain this action, the Court of Appeals below exalted judicially determined "policy" over the plain language of the statute in clear disregard of this Court's well-established Section 16(b) jurisprudence.

A. The Court Of Appeals Improperly Ignored The Plain Language Of Section 16(b)'s Standing Provisions

The opinion below makes clear the virtual exclusive reliance by the majority on its perception of the "policy behind the statute" in interpreting the language "owner of any security of the issuer" to include a person who is no longer such an owner. 909 F.2d at 729; 12a ("In keeping with the general rules of § 16(b) analysis, the question of whether a plaintiff has standing to bring suit is, in part, determined by whether the policy behind the statute is best served by allowing the claim."). Although the majority noted the principle that "only where differing constructions of § 16(b)'s terms are possible may a court interpret the statute in a way that serves Congress' purpose," *id.* at 728; 9a (citation omitted), it failed entirely to establish what it claimed to be the predicate for its heavy reliance on the policy behind the statute.

The majority's assertion that it was free to consider the policy behind the statute because the relevant language of Section 16(b) allowed alternative constructions, *id.* at 728; 10a (citing *Reliance Elec. Co. v. Emerson Elec. Co.*, 404 U.S. 418, 424 (1972); *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582, 594 (1973)), is insupportable. The language of Section 16(b) gives no indication whatsoever that a "former" owner of a security of the issuer may maintain an action. Besides issuers themselves, Congress chose to provide Section 16(b) standing only to those who are "the owner[s] of any security of the issuer"—a provision that cannot reasonably be read to include "a person who is not now an owner but once was the owner of any security of the issuer."

The majority turned the straightforward statutory language on its head by asserting that, since Congress did not insert the word "current" before the word "owner" in the statute, "former" owners may sue if the court determines that permitting such a suit would advance the remedial purpose of the statute. 909 F.2d at 730; 15a. It must be presumed, however, that when Congress imposes as a condition to standing to bring a lawsuit the requirement that the plaintiff have a specified status, it intends to require that the plaintiff have that status currently, rather than in the past. The use of the qualifier "current" would add nothing.[4]

Contrary to the reasoning of the court below, if Congress had for any reason intended to broaden the standing requirements of Section 16(b) to include former owners, it could easily have done so. *Lewis v. McAdam*, 762 F.2d 800, 803 (9th Cir. 1985) (per curiam). But Congress authorized only "owners"—not "owners or former owners"—to bring suit under Section 16(b). Nor is there anything in the legislative history remotely indicating that Congress intended such an illogical reading of the word "owner." *See id.* at 804 ("We find nothing in the legislative history of section 16(b) indicating that the plain meaning of the statutory language is inadequate to effect the congressional purpose of providing an enforcement mechanism against insider trading."); dissenting opinion below, 909 F.2d at 735-36; 28a. As this Court has admonished, "congressional silence . . . cannot override the words of the statute." *Sedima, S.P.R.L. v. Imrex Co.*, 473 U.S. 479, 495-96 n.13 (1985).

Under the plain meaning of Section 16(b), only an existing owner of a security of the issuer has standing to commence and maintain such an action. Whatever the merits or demerits

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4 Indeed, the majority's argument in support of its construction of the statute would support such absurd results as permitting diversity jurisdiction to exist in a suit between residents of the same state, so long as one of the parties formerly resided in a different state, simply because 28 U.S.C. § 1332(a)(1) is not limited to "current" citizens of different states.

of the statute's failure to extend standing to "former" owners of such a security, this limitation "is inherent in the statute as written, and its correction must lie with Congress," not with the courts. *Id.* at 499. As this Court noted in *Blau v. Lehman*, 368 U.S. 403, 413 (1962), in which the Court rejected a prior invitation by the Commission to judicially rewrite Section 16(b)'s scope, "Congress is the proper agency to change an interpretation of the [Exchange] Act unbroken since its passage, if the change is to be made." *See also TVA v. Hill*, 437 U.S. 153, 194 (1978) ("Our individual appraisal of the wisdom or unwisdom of a particular course consciously selected by the Congress is to be put aside in the process of interpreting a statute."); *Lewis, supra*, 762 F.2d at 804 ("We have no constitutional authority to rewrite a statute simply because we may determine that it is susceptible of improvement.") (citing *Badaracco v. Commissioner*, 464 U.S. 386 (1984)); *Untermeyer v. Valhi*, 665 F. Supp. 297, 300 (S.D.N.Y. 1987) ("[T]he statutory language may not be strained or distorted to add to the 'prophylactic' effect Congress itself clearly prescribed in § 16(b)."), *aff'd mem.*, 841 F.2d 1117 (2d Cir.), *aff'd on reh'g*, 841 F.2d 25 (2d Cir.), *cert. denied*, 488 U.S. 868 (1988). As the dissent below concluded:

> The statute unambiguously states that "the owner of any security of the issuer" may sue to recover short-swing profits that are recoverable by the issuer under § 16(b). There is simply no indication in any of the legislative history of § 16(b) that the plain meaning of the words "owner of any security of the issuer" was meant to include or even could include one who is no longer the owner of any security of the issuer. Nor is there anything in the legislative history from which to believe "that the plain meaning of the statutory language is inadequate to effect the congressional purpose of providing an enforcement mechanism against insider trading. That a merger may result in a corporation succeeding to an action formerly held by an individual is a consequence dictated by the statute." *Lewis*, 762 F.2d at 804. Certainly, Congress has had ample opportunity to amend § 16(b) had it so desired.

909 F.2d at 735-36; 28a-29a (footnote omitted).

B. The Court Of Appeals' Reliance On Perceived Policy In Expanding Upon The Language Of Section 16(b) Contradicts This Court's Long-Established Section 16(b) Jurisprudence

Section 16(b) is unique among the express civil liability provisions of the Securities Act of 1933 (the "Securities Act") and the Exchange Act. While every other express civil liability provision in the Securities Act or Exchange Act "contains a state-of-mind condition requiring something more than negligence," *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 209 n.28 (1976), Section 16(b) is, by its terms, a strict liability statute, imposing liability "irrespective of any intention on the part of [the] beneficial owner, director, or officer," Section 16(b), 15 U.S.C. § 78p(b). Moreover Section 16(b) is the only express civil liability provision in the Securities Act or Exchange Act that does not expressly limit standing to persons who purchase or sell securities in connection with the alleged violation.[5] *Cf. Blue Chip Stamps v.*

5 *See* Section 11 of the Securities Act, 15 U.S.C. § 77k (liability for material misstatements or omissions in a registration statement; right of action provided for "any person acquiring [a] security"); Section 12 of the Securities Act, 15 U.S.C. § 77*l* (liability for offers or sales of securities in violation of prospectus delivery requirements or by means of prospectus or oral communications that include material misstatements or omissions; right of action for "the person purchasing such security from" the defendant); Section 9(e) of the Exchange Act, 15 U.S.C. § 78i(e) (liability for certain fraudulent and manipulative practices; right of action for "any person who shall purchase or sell any security at a price which was affected by such act or transaction"); Section 18 of the Exchange Act, 15 U.S.C. § 78r (liability for false or misleading statements contained in certain documents filed with the Commission; right of action for "any person . . . who . . . shall have purchased or sold a security at a price which was affected by such statement"); Section 20A of the Exchange Act, 15 U.S.C. § 78t-1

Manor Drug Stores, 421 U.S. 723, 734 (1975) (citing Section 16(b) in support of the proposition that "[w]hen Congress wished to provide a remedy to those who neither purchase nor sell securities, it had little trouble in doing so expressly.").[6]

Partly in recognition of the broad sweep of Section 16(b), this Court has consistently required that its provisions be interpreted narrowly. Indeed, in every decision by this Court interpreting Section 16(b), this Court has rejected any proposed expansive interpretation of the statute.[7] In *Foremost-*

(liability for insider trading; right of action to "any person who, contemporaneously with the purchase or sale of securities that is the subject of such violation, has purchased . . . or sold . . . securities of the same class"). In addition, Section 29(b) of the Exchange Act, 15 U.S.C. § 78cc(b), provides a right of action to declare certain contracts made in violation of the Exchange Act void. Although the statute does not set forth an express standing requirement for all actions brought under it, it does provide an express limitations period for certain actions brought "by any person to or for whom any broker or dealer sells, or from or for whom any broker or dealer purchases, a security."

6 Section 16(b) also has a longer limitations period than the other express civil liability provisions of the Securities Act and Exchange Act. Section 16(b) claims may be brought up to two years "after the date [the] profit was realized." All other express civil actions under the Securities Act and Exchange Act must be brought within one year of the date of the violation or the date of discovery of the violation.

7 *Foremost-McKesson, Inc. v. Provident Sec. Co.*, 423 U.S. 232 (1976) (defendant must be 10% beneficial owner before purchase of securities is subject to § 16(b); not sufficient that purchase of securities causes defendant to become 10% beneficial owner); *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973) (binding option for defeated tender offeror to sell post-merger securities not deemed a "sale" under § 16(b) because potential for abuse not present); *Reliance Elec. Co. v. Emerson Elec. Co.*, 404 U.S. 418 (1972) (§ 16(b) applies only to sales occurring while defendant is 10% beneficial owner; sales occurring after defendant had reduced ownership to 9.96% outside scope of statute); *Blau v. Lehman*, 368 U.S. 403 (1962) (partnership of which director in issuer corporation was a partner could not be held liable under § 16(b) for profits earned by it in short-swing transactions).

McKesson, Inc. v. Provident Sec. Co., 423 U.S. 232, 251 (1976), this Court noted that Section 16(b) "imposes liability without fault within its narrowly drawn limits." The Court went on to say that "[i]t is inappropriate to reach the harsh result of imposing § 16(b)'s liability without fault on the basis of unclear language. If Congress wishes to impose such liability, we must assume it will do so expressly or by unmistakable inference." *Id.* at 252; *see also Reliance Elec.*, *supra*, 404 U.S. at 427 ("[W]e are not free to adopt a construction that not only strains, but flatly contradicts, the words of the statute."). As this Court has previously emphasized, because Section 16(b) imposes a standard of strict liability, it is generally applied with a "mechanical quality." *Reliance Elec.*, *supra*, 404 U.S. at 425.

In ignoring the plain, unambiguous language of the statute, the majority below not only disregarded, but flatly contradicted, the clear mandate of this Court not to construe Section 16(b) expansively even when the language is unclear. Indeed, the majority's statement that "[w]hen the statute permits interpretation the section traditionally has been read broadly in view of its remedial purposes," 909 F.2d at 728; 10a, stands on its head this Court's statement in *Foremost-McKesson* that ambiguities are to be resolved against liability.

Moreover, in the two decisions of this Court cited by the majority below as authority for its heavy reliance on the perceived policy underlying the statute, *Kern County Land Co.*, *supra*, and *Reliance Elec.*, *supra*, *see* 909 F.2d at 727-28; 8a-10a, as well as in every other decision of this Court addressing Section 16(b) (*see* note 7 *supra*), this Court actually declined to apply an expansive reading of Section 16(b). As this Court noted in *Foremost-McKesson*, *supra*, 423 U.S. at 252, "[i]n neither [*Kern County Land Co.* nor *Reliance Elec.*] did the Court adopt the construction that would have imposed liability, thus recognizing that serving the congressional purpose does not require resolving every ambiguity in favor of liability under § 16(b)."

The weakness of the majority's analysis in relying on perceived policy over the plain language of the statute is highlighted by the inconsistency with which it applies that analysis. In an effort to avoid the effect of prior decisions of other circuits, and of the Second Circuit itself, holding that shareholders who were completely "cashed out" in a merger involving the issuer did not have standing under Section 16(b), *see Portnoy v. Kawecki Berylco Indus., Inc.*, 607 F.2d 765, 767-68 (7th Cir. 1979); *Rothenberg v. United Brands Co.*, [1977-78 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,045 (S.D.N.Y. May 11, 1977), *aff'd mem.*, 573 F.2d 1295 (2d Cir. 1977), the majority limited its expansion of the standing requirement to "a novel situation where former shareholders have a continuing interest in maintaining suit in behalf of the issuer." 909 F.2d at 730-31; 16a-17a. This arbitrary, piecemeal expansion of the statute to provide standing to some, but not all, former holders of securities of the issuer (only those who now hold securities in the acquiror of the issuer) completely undercuts the majority's interpretation of the language of the statute as not limited to "current" shareholders. If the language of the statute were in fact susceptible of being interpreted as granting standing to those who formerly held securities of the issuer, there is no principled basis for distinguishing between those who were cashed out in a merger and those who received, in exchange for their securities in the issuer, securities of the issuer's acquiror.

The self-contradictory approach of the majority below demonstrates the dangers of embarking on inquiries into perceived policies behind statutes where such inquiries are not justified or compelled by the statutory language—especially where Section 16(b) is concerned. By relying on what it perceived as the sole policy behind Section 16(b) of preventing insider trading, the majority ignored Congress's clear countervailing policy—manifest in the language of the standing provisions of the statute itself—of providing standing for this strict liability statute only to a narrowly, and clearly, defined group of parties. *See Foremost-McKesson*, *supra*, 423 U.S. at 252 ("It is not irrelevant that Congress itself limited carefully the liability imposed by § 16(b).").

Although this Court has not previously addressed the issue of standing under Section 16(b), the decision of the Court of Appeals below is contrary to this Court's long-established principles of statutory construction in the Section 16(b) context. This Court should review that decision to clarify the applicable law in the important threshold question of standing in Section 16(b) cases.

II. THE DECISION OF THE COURT OF APPEALS DIRECTLY CONFLICTS WITH DECISIONS FROM THE SEVENTH AND NINTH CIRCUIT COURTS OF APPEALS

Despite the efforts of the majority below to avoid a conflict with prior decisions, its ruling that "owner of any security of the issuer" also means "former" owner of any security of the issuer is squarely at odds with rulings of the Seventh and Ninth Circuits—the only other Courts of Appeals that have addressed the issue—as well as with prior case law of the Second Circuit itself. These prior decisions confirmed that the plain meaning of "owner of any security in the issuer"—as set forth in Point I above—confers standing only on one who continues to be an owner of the issuer's securities throughout the lawsuit.

In *Portnoy v. Kawecki Berylco Indus., Inc.*, 607 F.2d 765 (7th Cir. 1979), a case that is virtually indistinguishable from the instant case, the plaintiff commenced a Section 16(b) action to recover profits from short-swing trading in shares of KBI. At the time the action was commenced, the plaintiff was a shareholder in KBI as well as another corporation (Cabot). Five days after the commencement of the action, KBI entered into a merger transaction in which shareholders of KBI were cashed out and as a result of which KBI became the wholly owned subsidiary of CSMC, which in turn was a subsidiary of Cabot. The plaintiff then amended his com-

plaint to assert that he was maintaining it on behalf of Cabot as well as KBI.

The Seventh Circuit was faced with two questions: Was the plaintiff still an "owner of any security of the issuer" (KBI) within the meaning of Section 16(b)? And did the plaintiff's status as a shareholder of Cabot give him standing under Section 16(b)? The court answered both questions in the negative.

As for the plaintiff's status as an "owner of any security of the issuer," the court ruled that once the plaintiff lost his shares of KBI, he lost his standing to sue on its behalf under Section 16(b). *Portnoy*, 607 F.2d at 767 (citing *Rothenberg v. United Brands Co.*, [1977-78 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,045 (S.D.N.Y. May 11, 1977), *aff'd mem.*, 573 F.2d 1295 (2d Cir. 1977)).

On the second question, whether owning a security of the grandparent of the issuer was sufficient to confer Section 16(b) standing, the court noted that the policy grounds used to permit such standing did not permit it to "rewrite the statute to accommodate this situation [since] Congress has spoken clearly." 607 F.2d at 768. The court noted that, as is true in this proceeding, the issuer still existed and its sole shareholder (there CSMC, here Viacom) "had the right to bring the action regardless of whether it chose to exercise that right." *Id.* at 769. In a passage that could easily have been directed at the reasoning of the Court of Appeals below, the Seventh Circuit further noted that "[i]t would be a dangerous precedent to confer standing on a plaintiff who falls outside the class of parties permitted by the language of the statute to bring suit merely because the only parties that fall within the class choose not to exercise their right to sue."[8] *Id.* Accordingly, the court ruled that the plaintiff lacked standing.

8 The court also noted that, although the result in *Portnoy* may appear to be "a harsh one in that a possible violation will apparently go uncorrected, we note on the more positive side that the plaintiff has not argued that the merger which cut off his standing . . . was accomplished for the fraudulent purpose of avoiding enforcement of the § 16(b) claim." *Id.* Similarly, Respondent has never contended in this case that the acquisition of International by Viacom was undertaken for the purpose of avoiding enforcement of Section 16(b). *See* dissenting opinion below, 909 F.2d at 732; 20a (noting that International was acquired by Viacom "in a merger transaction which had a business purpose").

The Ninth Circuit, in a decision by a panel that included Justice (then Judge) Kennedy, reached a similar result in *Lewis v. McAdam*, 762 F.2d 800 (9th Cir. 1985) (per curiam). There, Coldwell Banker was acquired by Sears through a wholly owned subsidiary of Sears, SDC. Thereafter Coldwell Banker ceased to exist as a separate corporate entity. The plaintiff who commenced this Section 16(b) action was a shareholder of Sears, and had never owned stock of Coldwell Banker or SDC. He sought the recovery of short-swing profits made by a director of Coldwell Banker through the director's sale of his Coldwell Banker shares.

In determining whether the plaintiff had standing, the *Lewis* court concluded that the answer was readily ascertained from the language of the statute:

> Section 16(b) permits a security holder of the issuer to bring a section 16(b) action only after the issuer has failed either to institute an action or to prosecute diligently after instituting an action. We find nothing in the legislative history of section 16(b) indicating that the plain meaning of the statutory language is inadequate to effect the congressional purpose of providing an enforcement mechanism against insider trading. That a merger may result in a corporation succeeding to an action formerly held by an individual is a consequence dictated by the statute. We will not confer standing on a plaintiff who falls outside the class of persons permitted by the language of the statute to bring suit merely because the only parties falling within the class choose not to exercise their right to sue. *Portnoy*, 607 F.2d at 769.

> Congress is well aware of the corporate practice of parent companies utilizing wholly owned subsidiaries in merger transactions. Had Congress wanted to discourage this practice by conferring standing on shareholders of a parent corporation whose wholly owned subsidiary absorbed the original issuing corporation, it knew how to do so.

762 F.2d at 804. Accordingly, the *Lewis* court concluded that the plaintiff lacked standing. *See also Staffin v. Greenberg*, 509 F. Supp. 825, 840 (E.D. Pa. 1981) ("[T]he law requires that to maintain a derivative action under section 16(b) a plaintiff must have and maintain his standing as a shareholder at the commencement of the law suit and throughout the litigation.") (citing *Portnoy*, *supra*, and *Rothenberg*, *supra*), *aff'd on other grounds*, 672 F.2d 1196 (3d Cir. 1982).

Prior to the holding of the Court of Appeals below, it had also been the law in the Second Circuit that a plaintiff security holder who commenced a Section 16(b) suit on behalf of an issuer had to own and continue to own his securities of the issuer throughout the litigation, and that if such a plaintiff ceased to own such securities—for any reason—he was denied standing to continue the action.[9] For example, in

9 One exception to this rule was the district court decision in *Blau v. Oppenheim*, 250 F. Supp. 881 (S.D.N.Y. 1966). In *Blau*, the court held that a shareholder of American Can Company could bring a Section 16(b) suit against a former director of a company which had sold all its assets to a subsidiary of American Can and thereafter ceased to exist. In sustaining the plaintiff's standing in *Blau*, the court noted that the original issuer had ceased to exist as a corporate entity after the transaction and thus it no longer had any shareholders who could sue. It concluded that to limit standing to the former shareholders of the now defunct issuer would mean that no one could possibly bring a Section 16(b) suit against the company's former directors. In so holding, the court, like the majority below, relied almost exclusively on the perceived policy behind the statute, virtually ignoring the language. *Id.* at 887 ("In sum, the essential argument which the defendant advances is one of language. But language alone can never be dispositive of a

Rothenberg v. United Brands Co., [1977-78 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,045 (S.D.N.Y. May 11, 1977), *aff'd mem.*, 573 F.2d 1295 (2d Cir. 1977), the district court held, and the Second Circuit affirmed, that a shareholder who had commenced a Section 16(b) suit lost his standing to continue that suit when he ceased to be a shareholder of the issuer as a result of a "short form" merger (in which public shareholders, including the plaintiff, had no vote) following a tender offer that the plaintiff had refused to accept.[10]

In *Herrmann v. Steinberg*, 812 F.2d 63 (2d Cir. 1987), the Second Circuit vacated and remanded a decision of the district court that had incorrectly calculated Section 16(b) short-swing profits. In what the Second Circuit described as "a threshold matter," the plaintiffs were admonished that on

statute's meaning."). Other courts have criticized *Blau*'s reasoning. *See, e.g.*, *Portnoy*, 607 F.2d at 769 n.8; *Lewis*, 762 F.2d at 803-04; dissenting opinion below, 909 F.2d at 734; 24a-26a. *Blau* is inapplicable to the instant case in any event because the issuer, International, survived the merger and remains a viable corporation as a wholly owned subsidiary of Viacom.

Prior to the decision below, *Blau* had been distinguished in the Second Circuit on the ground that the issuer in that case was no longer a viable corporate entity. *See Untermeyer v. Valhi, Inc.*, 665 F. Supp. 297, 300 (S.D.N.Y. 1987), *aff'd mem.*, 84 F.2d 1117 (2d Cir.), *aff'd on reh'g*, 841 F.2d 25 (2d Cir.), *cert. denied*, 488 U.S. 868 (1988). Although the majority below referred repeatedly to *Blau* with approval, the majority's "rule"—extending standing only to "a novel situation where former shareholders have a continuing interest in maintaining suit in behalf of the issuer", 909 F.2d at 730-31; 16a-17a—is actually inconsistent with *Blau*, where the plaintiff had never owned a security of the issuer.

10 The majority below "caution[ed] against an overbroad application of *Rothenberg*" in part on the ground that its "standing analysis was premised on an analogous application of Rule 23.1 which . . . does not govern shareholders bringing § 16(b) claims." 909 F.2d at 730; 16a. However, the *Rothenberg* court was well aware of the distinctions between Section 16(b) claims and Rule 23.1, *see Rothenberg* at 91,692, and the majority's opinion below even cited *Rothenberg* in a discussion of the distinctions between Section 16(b) claims and Rule 23.1. 909 F.2d at 728; 11a.

remand they "must establish that they have been [the issuer's] shareholders throughout this litigation." *Id.* at 67 n.4 (citing *Rothenberg, supra*; *Lewis, supra*; and *Portnoy, supra*).

Finally, in *Untermeyer v. Valhi, Inc.*, 665 F. Supp. 297 (S.D.N.Y. 1987), *aff'd mem.*, 84 F.2d 1117 (2d Cir.), *aff'd on rch'g*, 841 F.2d 25 (2d Cir.), *cert. denied*, 488 U.S. 868 (1988), the issuer (Sea-Land) was merged with another corporate entity such that Sea-Land survived and became the wholly owned subsidiary of CSX. In dismissing the plaintiff's Section 16(b) action—on the ground that the plaintiff, an owner of CSX stock, lacked standing because he was not the owner of any security in the issuer, Sea Land—the district court identified the only parties that would have standing to pursue such an action: the issuer (Sea-Land) or its sole shareholder (CSX). In affirming the district court's decision, the Second Circuit also identified these parties as the only entities that would be entitled to maintain a Section 16(b) action. Neither court included in the list "former" shareholders of Sea-Land.

The decision of the Court of Appeals below thus plainly stands out in stark contrast to these prior decisions of the Second, Seventh and Ninth Circuits in its willingness to expand the standing provisions of Section 16(b). Indeed, even the Commission, which filed an *amicus* brief in the Court of Appeals below in support of Respondent, has recognized—in releases issued in connection with a pending proposal by the Commission to amend its rules under Section 16(b)—that it was settled law prior to the Court of Appeals' decision in this case that Section 16(b) plaintiffs must hold their securities of the issuer throughout the course of the litigation. *See, e.g.*, Exchange Act Rel. No. 34-26333, [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 84,343, at 89,620-21.[11]

11 The majority opinion below cited the Commission's views, including the proposed new rules under Section 16(b), in support of its result, although it acknowledged that "the proposed rule is inapplicable in the

In an effort to characterize its decision as not conflicting with these established precedents from its own and other circuits, the majority below identified certain distinctions that purport to set the instant action apart from decisions discussed above.

The sole distinction the majority found in this proceeding from *Portnoy* and *Rothenberg* is that in those cases, the holders of the issuer's securities received only cash for their securities whereas in the instant action, Respondent received cash *and* some stock in the acquiror. The majority maintained that here, unlike in *Portnoy* and *Rothenberg*, Respondent—by virtue of receiving stock in the acquiror—"continues to have at least an indirect financial interest in the outcome of this lawsuit." 909 F.2d at 730; 16a. As for *Lewis* and *Untermeyer*, the majority noted as the sole distinction the fact that in those actions, the plaintiff never held stock in the issuer, but only in the parent corporation. *Id.* at 730; 15a-16a. These distinctions, however, lack substance.

As an initial matter, the majority did not explain why the statutory analysis followed in these cases is not applicable to this proceeding. As set forth above, the Seventh and Ninth Circuit Courts of Appeals have found the language of Section 16(b) at issue to be plain and unambiguous. As noted in Point I, *supra*, statutory language, if clear and unambiguous, will ordinarily be regarded as conclusive, "since it is generally assumed that Congress expresses its purpose through the ordinary meaning of the words it uses." *Lewis, supra*, 762 F.2d at 804 (citing *Escondido Mut. Water Co. v. La Jolla Band of Missions Indians*, 466 U.S. 765, 772 (1984);

case at hand." 909 F.2d at 730; 14a (citing *Mayer v. Chesapeake Ins. Co.*, 877 F.2d 1154, 1162 (2d Cir. 1989), *cert. denied*, 110 S. Ct. 722 (1990)). As the dissent noted, however, " '[the Commission's] presumed "expertise" in the securities-law field is of limited value when the narrow legal issue is one peculiarly reserved for judicial resolution, namely whether a cause of action should be implied by judicial interpretation in favor of a particular class of litigants.' " 909 F.2d at 734 n.2; 24a (quoting *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1, 41 n.27 (1977)).

North Dakota v. United States, 460 U.S. 300, 312 (1983); *Consumer Prod. Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980)). Similarly, the Court of Appeals failed to address the rejection in these prior decisions of the same "policy arguments" that appear to be the sole foundation for the result reached below.

More importantly, the distinctions drawn by the majority prove to be meaningless. First, the majority does not appear to disagree with the general rule that one who owns securities *only* in the parent of the issuer does not have standing under Section 16(b). *See* 909 F.2d at 730; 15a-16a (discussing *Untermeyer* and *Lewis*). The majority opinion, however, seeks to create an exception to this rule for a plaintiff whose securities of the issuer were exchanged for securities in the parent corporation in a merger transaction, thus giving the plaintiff "a continuing interest in maintaining suit in behalf of the issuer." *Id.* at 730; 16a-17a.

The majority's purported distinction wholly fails to explain the opposite result that was reached in *Portnoy*. The plaintiff in *Portnoy* owned securities of the grandparent corporation of the issuer at the time of the merger, and therefore had a "continuing financial interest in the litigation" in every sense that Respondent did here. The majority's implied distinction on the ground that Respondent received his shares in the issuer's parent *in exchange for* his shares of the issuer, while in *Portnoy* the plaintiff's ownership of shares in the issuer's grandparent was independent of the merger, is irrelevant both to the statutory language and to the majority's perception of the statutory design.[12]

12 The reasoning of the majority below, tied as it is to the concept of a security holder's continuing financial interest in the outcome of the litigation, is also fundamentally flawed in another respect. The majority reasoned that a shareholder of a parent of the issuer should have standing under this analysis because he may benefit indirectly from any recovery by the issuer. But this reasoning would only make sense, if at all, if the plaintiff owned an *equity* security in the parent (so that a

The majority's judicially crafted exception to the statutory requirement is also at odds with the settled jurisprudence under Section 16(b) with respect to post-transaction purchases of an issuer's securities. As the majority opinion noted:

> The standing requirements for shareholder derivative suits are not applicable to a § 16(b) plaintiff. Generally a derivative plaintiff must be a shareholder at the time of the transaction of which he complains . . . In contrast, in a § 16(b) suit the complaining stockholder need not have held his securities at the time of the objectionable transaction. Suit may be brought by the holder of any of the issuer's securities—equity or debt—regardless of whether the security held is of the same class as those subject to disgorgement as short-swing profits.

909 F.2d at 728-29; 11a-12a (citations omitted).

Under this "well established principle," *Portnoy*, *supra*, 607 F.2d at 767 n.3, because a Section 16(b) plaintiff does not have to own the issuer's securities at the time of the transaction complained of, it is possible (and often the case) that a plaintiff will actually purchase the issuer's security *after the transaction* for the express purpose of "purchasing" a Section 16(b) action. Accordingly, it is entirely irrelevant under Section 16(b) whether the plaintiff has a continuing financial interest in the issuer from the time of the transaction sued upon.

Applying this analysis to the facts of this proceeding requires that Respondent—who formerly held securities in the issuer but now owns only securities in the new parent—be treated for Section 16(b) purposes in the same manner as an individual who never held securities in the issuer but pur-

financial gain to the parent might increase the value of his shares). In general, a holder of a *debt* security could gain no financial benefit from a recovery by the issuer because his return is fixed. However, for purposes of Section 16(b) standing, it is immaterial whether the security owned by the plaintiff constitutes equity or debt. *See* majority opinion below, 909 F.2d at 728-29; 12a.

chased securities in the parent after the merger. But the majority below would arbitrarily deny standing to the latter and grant it to the former. *See* 909 F.2d at 730; 16a (distinguishing *Lewis*, where plaintiff never held securities in issuer). Even more arbitrary is the distinction the court below seeks to draw between Respondent—who received securities of the acquiror in exchange for his securities of the issuer and is given standing—and the plaintiff in *Portnoy* who, the majority concedes, could not obtain standing because his securities of the issuer were "cashed out" in the merger, even though he independently held securities in the post-merger grandparent corporation of the issuer *at the time of the merger*.

There is no support in the language of the statute, the legislative history or prior case law for distinguishing between a plaintiff who received securities of a parent *directly* in exchange for his securities in the issuer and one who received cash for his securities but already owned securities of the parent (as in *Portnoy*) or one who timely purchased securities of the parent thereafter (as in *Rothenberg*).[13]

Accordingly, there can be no meaningful distinction drawn between this case and the prior decisions of the other Courts of Appeals that have addressed this question, as well as prior decisions of the Second Circuit. Like the plaintiffs in *Portnoy* and *Rothenberg*, when Respondent lost his ownership interest in the issuer, he lost his standing to continue this action. Like the plaintiffs in *Lewis* and *Untermeyer*, the Respondent's ownership of securities of a parent of the issuer does not confer standing under the plain terms of the statute.

Therefore, the majority's holding that a shareholder of the issuer who loses that security and instead acquires a security of the parent corporation nevertheless continues to have standing, is inexorably in conflict with the plain language of

13 In *Rothenberg*, after being cashed out, the plaintiff purchased a security in the ultimate parent of the issuer in an effort to regain standing. The court did not decide whether this revitalized the plaintiff's standing because no demand had been made on the parent entity. *Rothenberg*, at 91,692-93.

Section 16(b) and the decisions of the two other Courts of Appeals that have addressed the issue (as well as with prior precedent in the Second Circuit itself). This Court should review the decision of the Second Circuit below to resolve this clear conflict.

CONCLUSION

For the foregoing reasons, the requested Writ of Certiorari should issue.

Dated: October 22, 1990

Respectfully submitted,

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APPENDICES

APPENDIX A

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 468, 562—August Term 1989

(Argued November 21, 1989 Decided July 25, 1990)

Docket Nos. 89-7068, 89-7686

IRA L. MENDELL, in behalf of Viacom, Inc. and, alternatively, Viacom International, Inc.,

Plaintiffs-Appellant,

—v.—

KEITH R. GOLLUST, PAUL E. TIERNEY, JR., AUGUSTUS K. OLIVER, GOLLUST TIERNEY and OLIVER, GOLLUST & TIERNEY, INC., CONISTON PARTNERS, CONISTON INSTITUTIONAL INVESTORS, BAKER STREET PARTNERS, WJB ASSOCIATES, HELSTON INVESTMENT, INC., VIACOM INC., and VIACOM INTERNATIONAL, INC.,

Defendants-Appellees.

Before:

OAKES, *Chief Judge*, CARDAMONE, *Circuit Judge*, and POLLACK, *District Judge*.*

* Hon. Milton Pollack, United States District Court for the Southern District of New York, sitting by designation.

Plaintiff, Ira L. Mendell, appeals from an order of the District Court for the Southern District of New York (Mukasey, J.), entered November 9, 1988, granting defendants' motion for summary judgment and dismissing plaintiff's complaint on the grounds that plaintiff lacked standing to bring the claim. Plaintiff also appeals an order, entered May 24, 1989, denying his motion for relief from the November 9, 1988 order and judgment of dismissal pursuant to Federal Rule of Civil Procedure 60(b).

The order of November 9, 1988 is reversed and remanded.

The order of May 24, 1989 is affirmed.

Judge Pollack dissents in a separate opinion.

IRVING MALCHMAN, New York, New York (Kaufman Malchman Kaufmann & Kirby, New York, New York, of counsel), *for Plaintiff-Appellant.*

EDWIN B. MISHKIN, New York, New York (James W. Pharo, Michael S. Sommer, Cleary, Gottlieb, Steen & Hamilton, New York, New York, of counsel), *for Defendants-Appellees other than nominal parties Viacom Inc., and Viacom International, Inc.*

SECURITIES and EXCHANGE COMMISSION, Washington, D.C. (Daniel L. Goelzer, General Counsel, Jacob H. Stillman,

Associate General Counsel, Thomas L. Riesenberg, Assistant General Counsel, Leslie E. Smith, Attorney, and Paul Gonson, Solicitor, Washington, D.C., of counsel), *filed a brief for the Securities and Exchange Commission, Amicus Curiae.*

CARDAMONE, *Circuit Judge*:

This appeal deals with a suit brought to recover short-swing profits against insiders which was dismissed in the district court. It is clear from Supreme Court precedent that liability for short-swing trading will not arise unless the securities transactions at issue fall within the literal language of the statute that prohibits over-reaching by insiders. Here plaintiff's standing to bring suit against insiders, rather than such individuals' liability, is the question presented. In resolving this issue the words of the statute must still be carefully examined, but legislative purpose may also be considered where standing is not clearly precluded by the statutory language. Congressional policy is a stubborn thing; it permeates this area of the law. In resolving this case therefore we must not defeat Congress' plain policy by viewing standing too narrowly.

BACKGROUND

Before us is an order of the Southern District of New York (Mukasey, J.), entered November 9, 1988 that granted summary judgment to defendants dismissing plaintiff's complaint for lack of standing. Plaintiff also

appeals from an order dated May 23, 1989 denying his Rule 60(b) motion for relief from the November 9, 1988 order. Plaintiff appeals that dismissal of his action brought pursuant to § 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b) (1988). Section 16(b) provides that an owner of an issuer's security may bring an action in behalf of the issuer to recover short-swing profits realized by the corporation's officers, directors and principal stockholders. A "short-swing" profit occurs when a profit is realized on a purchase and sale, or sale and purchase, of stock occurring within a period of six months. The statute requires officers, directors and owners of more than ten percent of the issuer's stock (insiders) to disgorge short-swing profits back to the issuer.

The question presented is whether a shareholder whose shares in an issuer are converted by a business restructuring into shares of a newly formed parent corporation that owns all of the stock of the issuer loses standing to maintain a previously instituted § 16(b) suit. Because we think the answer to the question posed is "no," the grant of summary judgment dismissing plaintiff's suit must be reversed.

FACTS

Plaintiff Ira L. Mendell is a former shareholder of Viacom International Inc. (International). Defendants are limited partnerships, general partnerships, individual partners and certain corporations (Coniston or the Coniston defendants) that together invested in the stock of International. In 1986 defendants collectively owned more than ten percent of its stock. In January 1987 plaintiff filed a complaint alleging that Coniston was

liable to International pursuant to § 16(b) for profits arising out of Coniston's purchases and sales of International stock in 1986. Plaintiff asserted that on trades of International stock made between July and October 1986 the Coniston defendants acquired approximately 11 million dollars in short-swing profits at a time when they were insiders by virtue of their ownership of more than ten percent of International stock. The complaint also alleged that in October 1986 a demand was made upon International and its Board of Directors to institute a § 16(b) suit against the Coniston defendants, but that though more than 60 days had passed no suit had been commenced by International.

Approximately six months later, in June 1987, after plaintiff had filed suit, International was acquired through a merger transaction by Arsenal Acquiring Corporation, a shell corporation formed for that purpose. All of International's stock was exchanged for a combination of cash and stock in Arsenal Acquiring's parent corporation called Arsenal Holdings, Inc., and Arsenal Acquiring then merged into International, which thereby became a wholly-owned subsidiary of the parent, Arsenal Holdings. As part of the merger, Arsenal Holdings changed its name to Viacom, Inc. (Viacom). Thus plaintiff, who held shares in International when he brought suit to recover insider profits for the issuer, now holds shares in its parent, Viacom. Viacom is the sole shareholder of International, and International is the parent corporation's sole asset.

At a pretrial conference held in February 1988 defendants asserted that plaintiff no longer had standing to maintain his § 16(b) suit since he was no longer a shareholder of International. In March 1988 plaintiff served

an amended complaint asserting that he had standing to bring the action in behalf of Viacom, the parent corporation, which he claimed was effectively the "issuer." Alternatively, he contended that he had standing to bring the action as a double-derivative action in behalf of International. Coniston moved for summary judgment. On November 9, 1988 the district court granted summary judgment to defendants because plaintiff lacked standing, ruling that "[s]uits to disgorge ill-gotten gains under § 16(b) may be prosecuted only by the issuer itself or the holders of its securities." *Mendell v. Gollust*, [1988-89] Fed. Sec. L. Rep. (CCH) ¶ 94,086 at 91,086 (S.D.N.Y. 1988).

On January 9, 1989—after the opinion issued but before the judgment of dismissal was entered on January 17, 1989—plaintiff purchased a subordinated note issued by International. In March 1989 plaintiff made a motion pursuant to Fed. R. Civ. P. 60(b) asserting that he now had standing as a noteholder of International, and that the judgment entered some weeks earlier should be vacated. In an opinion dated May 23, 1989 the district court denied the Rule 60(b) motion stating that counsel's failure to advise his client to purchase the note earlier did not provide grounds to overturn the judgment. *See Mendell v. Gollust*, [Current Volume] Fed. Sec. L. Rep. (CCH) ¶ 94,477 (S.D.N.Y. 1989).

We heard oral argument on November 21, 1989, and on November 28 requested the Securities and Exchange Commission (SEC) to submit an *amicus curiae* brief setting forth its views on plaintiff's standing under § 16(b). We now have the benefit of the SEC's *amicus curiae* brief filed on January 10, 1990.

DISCUSSION

I Section 16(b)

A. *Policy Considerations and Legislative Purpose*

In order to determine how broadly § 16(b)'s standing requirements should be construed, we begin with a brief examination of the policy considerations and the legislative purpose that preceded the enactment of the statute. The Securities Act of 1934 in general and § 16(b) in particular were passed to insure the integrity of the securities markets and to protect the investing public. *See* 15 U.S.C. § 78p(b) (1988); Federal Securities Exchange Act of 1934, S. Rep. No. 792, 73d Cong., 2d Sess. 9 (1934) [*Senate Report*]; 2 L. Loss, *Securities Regulation* 1037-38, 1040-41 (2d ed. 1961).

The Committee on Banking and Currency heard many instances where insiders either personally or through the medium of holding companies made large profits from the use of information not available to the public. *Senate Report* at 9. It concluded that the reporting requirements regarding changes in insider holdings and the provision making profits recoverable on sales or purchases made within six months would render difficult or impossible trading on advance information by insiders for profit. *Id.* The bill's provisions were for the express purpose of preventing the unfair use of inside information. *Id.* at 21.

> Among the most vicious practices unearthed at the hearings before the subcommittee was the flagrant betrayal of their fiduciary duties by directors and officers of corporations who used their positions of trust and the confidential information which came

> to them in such positions, to aid them in their market activities.

Stock Exchange Practices, Report of the Committee on Banking and Currency, S. Rep. No. 1455, 73d Cong., 2d Sess. 55 (1934). Hence, Congress envisioned § 16(b) as a remedial law that would deter those "intrusted with the administration of corporate affairs or vested with substantial control over corporations [from using] inside information for their own advantage." *Id.* at 68.

B. *Judicial Construction of § 16(b)*

Since its passage the Supreme Court has construed § 16(b) in a number of cases. In the earliest, *Blau v. Lehman*, 368 U.S. 403 (1962), it refused to hold an entire partnership liable for short-swing profits as an insider when one of its members was a director of the issuer because the plain language of § 16(b) did not provide for partnership liability, though the director was susceptible to suit in his individual capacity for the profits he realized. *Id.* at 411-14. In *Kern County Land Co. v. Occidental Petroleum Corp.*, 411 U.S. 582 (1973), a tender-offeror that purchased more than ten percent of the stock of Kern County Land Co. had its shares of Kern converted into new Tenneco stock when Tenneco merged with Kern in a defensive transaction. The tender-offeror negotiated a contract to sell to Tenneco the shares it would receive after the merger. Writing that traditional cash-for-stock purchases fall within § 16(b), but that certain "unorthodox" transactions are not so easy to resolve, the Court observed that these "borderline" transactions are within the statute's reach if they are a vehicle promoting the evil Congress

sought to prevent. *Id.* at 593-94. The Court noted that the transaction in question was not based on a statutory insider's information and therefore was not vulnerable to the speculative abuse barred by § 16(b), and held that neither the exchange of shares in the merger nor the execution of the option contract constituted a "sale" under § 16(b). *See id.* at 600-01.

In *Reliance Electric Co. v. Emerson Electric Co.*, 404 U.S. 418 (1972), Emerson Electric, a holder of more than ten percent of Dodge Manufacturing Co., made two sales of stock within six months after purchasing it, the first of which reduced its holdings to less than ten percent. The question was whether the profits from the second sale, made within six months of its purchase but not while Emerson was a ten percent holder, were recoverable by the corporation under § 16(b). In holding that they were not, the Supreme Court observed that a ten percent owner must under the statute be such " 'both at the time of the purchase and sale . . . of the security involved,' " 15 U.S.C. § 78p(b), and since Emerson Electric was not such an owner at the time of the second sale, the method it had used to avoid liability was one permitted by the statute. 404 U.S. at 422-23. The Court reasoned that, because liability under the statute is predicated upon objective proof, a trader's intent and/or motive is irrelevant and hence, Emerson Electric was not liable under § 16(b). *Id.* at 425. In *Reliance* the statutory language was clear; only where differing constructions of § 16(b)'s terms are possible may a court interpret the statute in a way that serves Congress' purpose. *Id.* at 424. Here, we are faced with the latter scenario.

C. *Broad Interpretation of § 16(b)*

When the statute permits interpretation the section traditionally has been read broadly in view of its remedial purposes. The disgorgement provision is aimed at deterring insider trading by removing the profits from "a class of transactions in which the possibility of abuse [is] believed to be intolerably great." *Id.* at 422. The statute presumes that insiders in a company have access to nonpublic information regarding its operation and will use that information when trading in the issuer's stock, and thus proof of the actual use of such inside information is not required. *See Foremost-McKesson, Inc. v. Provident Sec. Co.*, 423 U.S. 232, 243, 251 (1976); *Reliance Elec.*, 404 U.S. at 422; *Smolowe v. Delendo Corp.*, 136 F.2d 231, 235-36 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943).

We and most other courts have adopted a "pragmatic" approach, construing § 16(b) in a manner that seems most consistent with Congress' purpose. *See Kern County Land Co.*, 411 U.S. at 594 ("the courts have come to inquire whether the transaction may serve as a vehicle for the evil which Congress sought to prevent"); *Reliance Elec.*, 404 U.S. at 424 ("where alternative constructions of the terms of § 16(b) are possible, those terms are to be given the construction that best serves the congressional purpose of curbing short-swing speculation by corporate insiders."); *Feder v. Martin Marietta Corp.*, 406 F.2d 260, 262 (2d Cir. 1969) (courts interpret § 16(b) in ways most consistent with legislative purpose "even departing where necessary from the literal statutory language."), *cert. denied*, 396 U.S. 1036 (1970).

II Standing Under § 16(b)

A. *Broadly Construed*

To effectuate its purposes the statute permits "the owner of any security of the issuer" to bring suit in behalf of the corporation. 15 U.S.C. § 78p(b). Such person may institute a § 16(b) claim in behalf of the issuer if the latter fails to bring suit after the stockholder so requests. *See id.* Because such a suit is not brought in his own, but rather the corporation's behalf, § 16(b)'s standing requirements have been given wide latitude. *See Pellegrino v. Nesbit*, 203 F.2d 463, 466 (9th Cir. 1953); *see also Prager v. Sylvestri*, 449 F. Supp. 425, 429 (S.D.N.Y. 1978) (demand requirement of § 16(b) exists for benefit of the issuer; defendant insider may not assert lack of demand as a defense.). A § 16(b) plaintiff performs a public rather than a private function and is seen as an instrument for advancing legislative policy. *See Magida v. Continental Can Co.*, 231 F.2d 843, 846-47 (2d Cir.), *cert. denied*, 351 U.S. 972 (1956).

The standing requirements for shareholder derivative suits are not applicable to a § 16(b) plaintiff. *See Blau v. Mission Corp.*, 212 F.2d 77, 79 (2d Cir.), *cert. denied*, 347 U.S. 1016 (1954); *Rothenberg v. United Brands Co.*, [1977-78] Fed. Sec. L. Rep. (CCH) ¶ 96,045 at 91,691-92 (S.D.N.Y.); *aff'd mem.*, 573 F.2d 1295 (2d Cir. 1977); 2 L. Loss, *Securities Regulation* at 1045-47. Generally a derivative plaintiff must be a shareholder at the time of the transaction of which he complains, the action must not be a collusive one to confer federal jurisdiction, and the complaint must allege with particularity the efforts made to obtain the desired action. *See* Fed. R. Civ. P. 23.1. In contrast, in a

§ 16(b) suit the complaining stockholder need not have held his securities at the time of the objectionable transaction. *See Blau v. Mission Corp.*, 212 F.2d at 79. Suit may be brought by the holder of any of the issuer's securities—equity or debt—regardless of whether the security held is of the same class as those subject to disgorgement as short-swing profits. *See* 15 U.S.C. § 78p(b); *Smolowe*, 136 F.2d at 241; 2 L. Loss, *Securities Regulation* at 1046. Further, the amount or value of a plaintiff's holdings or his motives for bringing suit are not relevant. *See Magida*, 231 F.2d at 847-48.

In keeping with the general rules of § 16(b) analysis, the question of whether a plaintiff has standing to bring suit is, in part, determined by whether the policy behind the statute is best served by allowing the claim. Thus, in *Blau v. Oppenheim*, 250 F. Supp. 881 (S.D.N.Y. 1966) (Weinfeld, J.), the district court permitted a shareholder of a *parent corporation* to bring a § 16(b) suit on behalf of its issuer-subsidiary. There the company that issued the stock that was traded in contravention of the statute was dissolved in a merger. The court reasoned that where the issuer is merged out of existence, none of the original shareholders are left to bring suit. *Id.* at 886. A holding that would allow only the shareholders of the now defunct issuer to remedy the statutory violation would therefore make the statute unenforceable. *See id.* at 886-87; *see also Portnoy v. Kawecki Berylco Indus. Inc.*, 607 F.2d 765, 768 (7th Cir. 1979). In order to avoid a result that was contrary to the purpose of the statute the court interpreted the word "issuer" to include the parent corporation. *Oppenheim*, 250 F. Supp. at 884.

Defendants urge that we limit *Oppenheim* to permit a shareholder of a parent corporation to maintain a § 16(b) suit with respect to the subsidiary's stock only when the original issuer did not survive a merger into the subsidiary. They contend that when the issuer survives the merger as a viable corporate entity enforcement of the statute by the issuer or by its shareholder, the parent corporation, is still available. We disagree with defendants' rationale; it would have been equally applicable to *Oppenheim* because there the § 16(b) claim could have been brought by the issuer's survivor or by its shareholder, the parent corporation, yet the court did not restrict standing to those entities. The plaintiff in *Oppenheim* actually had less claim to standing than the plaintiff in the instant case, because in *Oppenheim* the plaintiff never held shares in the original issuer, but purchased shares in the parent only after the merger. Further, we do not rely on the interpretation of "issuer" set forth in *Oppenheim*, but focus instead on whether a security holder loses his standing as an "owner" of securities when his stock is involuntarily converted in a merger.

The probability that the statute will not be enforced is present to the same degree when the original issuer survives the merger as a wholly-owned subsidiary of the parent corporation as it was in *Oppenheim*. In such circumstance no public shareholders remain to bring an action. As a practical matter it is unrealistic to believe that the issuing corporation will bring an action against itself or its insiders. *See Rothenberg*, [1977-78] Fed. Sec. L. Rep. ¶ 96,045 at 91,691; *cf. Lewis v. McAdam*, 762 F.2d 800, 802 (9th Cir. 1985) (per curiam); *Magida*, 231 F.2d at 846. Leaving insiders to police themselves is not only contrary to § 16(b)'s private shareholder enforce-

ment purpose, but also can be expected to secure the same results as those obtained when a fox guards a chicken coop. Concededly, some protection against insider abuse may still be available through a stockholder's derivative suit for breach of fiduciary duty. Yet such a suit is not as effective as a § 16(b) claim because shareholders are subject to the already noted more stringent standing requirements of Rule 23.1, and, in addition, the complaint may be countered with subjective considerations of intent or good faith, such as a business judgment defense. *Cf. Oppenheim*, 250 F. Supp. at 887.

Moreover, the SEC endorses the view that the policy of § 16(b) is best effectuated by allowing plaintiff to maintain this suit. *See* Ownership Reports and Trading By Officers, Directors and Principal Stockholders, Securities Exchange Act Rel. No. 26333 (Dec. 2, 1988), 42 SEC Docket 570, 53 Fed. Reg. 49997 (Dec. 13, 1988) [SEC Rel. No. 26333]. Although not binding on us, the SEC's insights in construing securities laws are entitled to consideration. *See Basic Inc. v. Levinson*, 485 U.S. 224, 239 n.16 (1988); *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 n.10 (1976).

Proposed SEC Rule 16a-1(h) would specifically define "owner" of a security as either a current beneficial owner of securities of the issuer at the time suit was filed *or* a former beneficial owner who was compelled to relinquish his holdings as a result of a business combination. *See* SEC Rel. No. 26333. While the proposed rule is inapplicable in the case at hand, *cf. Mayer v. Chesapeake Ins. Co.*, 877 F.2d 1154, 1162 (2d Cir. 1989), *cert. denied*, 110 S. Ct. 722 (1990), it reflects the strength of the SEC's convictions.

B. *Standing Not Barred by Existing Law*

Defendants and the dissenting opinion assert it is "settled law" that a security holder who commences a § 16(b) suit must remain a security holder throughout the litigation and if he ceases to own the securities he loses his standing to continue the action. *See Untermeyer v. Valhi, Inc.*, 665 F. Supp. 297 (S.D.N.Y. 1987), *aff'd mem.*, 841 F.2d 1117 (2d Cir.), *aff'd on rehearing*, 841 F.2d 25 (2d Cir.) (per curiam), *cert. denied*, 109 S. Ct. 175 (1988); *Rothenberg*, [1977-78] Fed. Sec. L. Rep. (CCH) ¶ 96,045; *see also Lewis*, 762 F.2d 800; *Portnoy*, 607 F.2d 765; *Staffin v. Greenberg*, 509 F. Supp. 825, 840 (E.D. Pa. 1981), *aff'd on other grounds*, 672 F.2d 1196 (3d Cir. 1982). That conclusion is not mandated either by the statutory language or by the cited cases.

First, the language of the statute speaks of the "owner" of securities; but such language is not modified by the word "current" or any like limiting expression. The statute does not specifically bar the maintenance of § 16(b) suits by former shareholders and Congress, had it so desired, could readily have eliminated such individuals as plaintiffs. The broad meaning of the word owner better accords with the remedial purpose of the statute. Second, although some decisions have denied standing to a § 16(b) plaintiff on the grounds that he is not a current security holder, those cases are distinguishable. The district court, for example, relied upon *Untermeyer v. Valhi, Inc.*, which dealt with a plaintiff who owned stock of the parent corporation, but who never owned stock of the company that issued the shares traded in contravention of § 16(b). 665 F. Supp at 298. Thus, even without a merger the *Untermeyer* plaintiff would not have had standing. In con-

trast, plaintiff here brought a valid § 16(b) suit while he was a current shareholder of the issuer, and *but for* the merger standing would not be in issue here.

In *Rothenberg v. United Brands Co.*, also cited by the district court, the shareholders received cash in the merger instead of securities. The crucial factor considered by the trial court was that in a cashout merger the former shareholders maintain no continuing financial interest in the litigation. *See Rothenberg*, [1977-78] Fed. Sec. L. Rep. (CCH) ¶ 96,045 at 91,692. In the present case all former International shareholders obtained, as a result of the merger, shares of International's parent corporation, and plaintiff, as one of them, continues to have at least an indirect financial interest in the outcome of this lawsuit. Two additional reasons caution against an overbroad application of *Rothenberg*: That decision noted that even if plaintiff had standing the § 16(b) claim failed on the merits, *see id.* at 91,693-94; and the court's standing analysis was premised on an analogous application of Rule 23.1 which, as noted above, does not govern shareholders bringing § 16(b) claims. *Id.* at 91,691-92.

Contrary decisions of our sister circuits are similarly distinguishable. *See Lewis*, 762 F.2d at 801 (plaintiff shareholder of parent but never held stock in the issuer or its surviving subsidiary); *Portnoy*, 607 F.2d at 767-68 (cashout merger left plaintiff with no continuing financial interest in the litigation; plaintiff's alternative status as a shareholder in the grandparent corporation gave no standing for § 16(b) suit on behalf of the issuer). In the case at bar, the conversion of International stock into Viacom stock presents a novel situation where former shareholders have a continuing interest in maintaining

suit in behalf of the issuer. We conclude, therefore, that under those unique circumstances the cases cited by defendants are neither controlling nor persuasive.

Here plaintiff's suit was timely, and while his § 16(b) suit was pending he was involuntarily divested of his share ownership in the issuer through a merger. But for that merger plaintiff's suit could not have been challenged on standing grounds. Although we decline—in keeping with § 16(b)'s objective analysis regarding defendants' intent—to inquire whether the merger was orchestrated for the express purpose of divesting plaintiff of standing, we cannot help but note that the incorporation of Viacom and the merger proposal occurred after plaintiff's § 16(b) claim was instituted. Hence, the danger of such intentional restructuring to defeat the enforcement mechanism incorporated in the statute is clearly present.

Quite plainly, a rule that allows insiders to avoid § 16(b) liability by divesting public shareholders of their cause of action through a business reorganization would undercut the function Congress planned to have shareholders play in policing such actions. *See Oppenheim*, 250 F. Supp. at 887; SEC Rel. No. 26333.

Permitting plaintiff to maintain this § 16(b) suit is not barred by the language of the statute or by existing case law, and it is fully consistent with the statutory objectives. The grant of summary judgment must therefore be reversed. If it is established that profits were realized in contravention of the statute they should be disgorged to International. The section is designed to protect fairness interests, not provide compensatory relief. The result we reach will adequately protect the former International shareholders who now own International indirectly as

shareholders of Viacom. *Cf. American Standard, Inc. v. Crane Co.*, 510 F.2d 1043, 1060-61 (2d Cir. 1974), *cert. denied*, 421 U.S. 1000 (1975).

Because the plaintiff has standing under § 16(b), we do not reach the district court's rejection of plaintiff's standing argument based upon an alleged "double derivative" action. *See Mendell*, [1988-89] Fed. Sec. L. Rep. (CCH) ¶ 94,086 at 91,087.

III Plaintiff's Standing as a Noteholder Under Fed. R. Civ. P. 60(b)

In light of our reversal of the November 9, 1988 order and subsequent judgment of dismissal gives plaintiff his requested relief, plaintiff's appeal of the motion brought pursuant to Rule 60(b) is to some extent mooted. Nevertheless, we write to affirm the district court's denial of the Rule 60(b) motion in order to emphasize that plaintiff's purchase of a senior subordinated note of International did not provide grounds to vacate the district court's initial order.

The relevant portions of Rule 60(b) provide that "upon such terms as are just, the court may relieve a party . . . from a final judgment [or] order . . . for the following reasons: (1) mistake, inadvertence, surprise, or excusable neglect; . . . or (6) any other reason justifying relief from the operation of the judgment." Fed. R. Civ. P. 60(b). Motions under Rule 60(b) are addressed to the sound discretion of the district court and are generally granted only upon a showing of exceptional circumstances. *Nemaizer v. Baker*, 793 F.2d 58, 61 (2d Cir. 1986).

Plaintiff argues that he purchased the International note "as soon as it occurred to plaintiff's counsel (1) that any security holder of International could maintain a 16(b) action *and* (2) that notes of International were available to be purchased." We agree with the district court that counsel's ignorance of the law on this point cannot form the basis for relief under subdivision (1) of Rule 60(b). *See id.* at 62-63. Nor can we say that the district court abused its discretion when it denied relief under subdivision (6) of Rule 60(b). Plaintiff's acquisition of a note following an adverse ruling on his claim to standing as a shareholder did not present the kind of "extraordinary" circumstance that mandates relief to avoid an "extreme and undue hardship." *See Ackermann v. United States*, 340 U.S. 193, 199 (1950); *Matarese v. LeFevre*, 801 F.2d 98, 106 (2d Cir. 1986), *cert. denied*, 480 U.S. 908 (1987).

As a noteholder of International, plaintiff clearly has standing to bring a § 16(b) claim in International's behalf. *See* 15 U.S.C. § 78p(b). Yet his newly acquired noteholder status does not afford grounds to vacate an order premised on his status as a former shareholder.

CONCLUSION

The district court's order entered May 24, 1989 is affirmed. Its order entered November 9, 1988 and the subsequent judgment of dismissal entered January 17, 1989 are reversed and the case is remanded to the district court for further proceedings consistent with this opinion.

MILTON POLLACK, *Senior District Judge*, dissenting:

The majority's ruling departs from the unequivocal terms of the statute to be administered and from the prior case law of this Court applying the statute, and it conflicts with rulings of the other Circuits which have addressed the requirements of the statute, § 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b).

A corporate merger during the pendency of this suit has sparked the judicial controversy presented to this Court.

Plaintiff was the owner of stock issued by International (Viacom International Inc.) at the time he filed this suit. He seeks to recover short-swing profits of beneficial owners of more than 10% of the stock of International. During the pendency of the suit, the plaintiff ceased being an owner of International stock as the result of a corporate merger. The defendants then moved, successfully, to dismiss the complaint. That dismissal is on appeal to this Court.

International had been organized as a wholly-owned subsidiary of CBS Inc. for the purpose of owning the television program distribution and cable television businesses of CBS. The CBS interest in International was distributed to the CBS stockholders on a pro rata basis. Some time later, Arsenal Holdings Inc. ("Holdings") was organized for the purpose of acquiring International in a merger transaction which had a business purpose. A wholly-owned subsidiary of Holdings was merged with and into International, and, as a result of the merger, International remained a viable corporate entity but became an indirect, wholly-owned subsidiary of Holdings. Holdings changed its name to Viacom, Inc.

("Viacom"). Each share of Viacom stock, including plaintiff's stock, was converted into the right to receive (i) $ 43.20 and (ii) certain percentages of preferred and common stock of Viacom.[1] Plaintiff accepted the conversion and received cash and Arsenal Holdings (now called "Viacom") stock in the exchange.

Refined to simpler understanding of the implication of the corporate merger, it appears that the plaintiff ceased to be a shareholder of International; he had exchanged his holdings in the issuer, International, for cash and preferred and common stock of Arsenal Holdings Inc., which had become the 100% owner of International in the merger. Under the merger exchange the previously outstanding stock of International was cancelled, including plaintiff's shares. In this state of affairs, under the explicit language of § 16(b), the right to bring a § 16(b) suit on behalf of International, the issuer, was limited to either International, the original issuer, or Viacom, its new sole stockholder.

Thus the grounds of difference between the majority of the Court and this dissent are that the plaintiff no longer satisfies the plain statutory requirement—ownership of securities of the issuer.

Prior to the holding of the majority herein, it was axiomatic that an "owner of any security of the issuer" must continue to be a stockholder of the issuer throughout a § 16(b) lawsuit. *See Herrmann v. Steinberg*, 812 F.2d 63, 67 n.4 (2d Cir. 1987) ("As a threshold matter . . . plaintiffs must establish that they have been . . . shareholders *throughout* this litigation."); *Rothenberg v.*

1 Excluded from the conversion were dissenting shares and shares held by Viacom, by International, or by a subsidiary of Viacom.

United Brands Co., [1977-78] Fed. Sec. L. Rep. (CCH) ¶ 96,045 at 91,691 (S.D.N.Y.) ("to continue to maintain a derivative action in the right of a corporation, plaintiff must have and *maintain his standing* throughout the litigation."), *aff'd mem.*, 573 F.2d 1295 (2d Cir. 1977); *Staffin v. Greenberg*, 509 F. Supp. 825, 840 (E.D. Pa. 1981) ("the law requires that to maintain a derivative action under section 16(b) a plaintiff must have and *maintain his standing* as a shareholder at the commencement of the law suit and throughout the litigation."), *aff'd on other grounds*, 672 F.2d 1196 (3d Cir. 1982) [Emphases supplied].

This Circuit as well as other circuits likewise have denied standing to sue to a § 16(b) plaintiff who has ceased his stock ownership in the issuer regardless of whether he voluntarily sold his interest or because he was cashed out in a merger transaction. *See Rothenberg v. United Brands Co.*, [1977-78] Fed. Sec. L. Rep. at 91,692 ("Here, we hold only that the requirement of § 16(b) that the plaintiff be the owner of any security of the issuer is not satisfied where plaintiff loses his security owner status [by a statutory short form merger] and thus any proprietary interest in the issuer during the pendency of the action."); *Portnoy v. Kawecki Berylco Indus.*, 607 F.2d 765, 767 (7th Cir. 1979) ("When the plaintiff filed his § 16(b) action, he was an owner of a security of the issuer (KBI). However, he lost that status five days later [when he was cashed out in a merger], and consequently, we are of the opinion that he lost the standing that he had as an owner of KBI stock.").

Those holdings follow traditional rulings in other contexts. Once a plaintiff loses his status as the owner of stock in the issuer, the terminated ownership does not

present a case or controversy for the exercise of judicial power; the claims by a terminated owner are not justiciable any longer. "The rule in federal cases is that an actual controversy must be extant at all stages . . . , not merely at the time the complaint was filed." *Preiser v. Newkirk*, 422 U.S. 395, 401 (1975). "[I]t is not enough that there may once have been a controversy at the time the suit was commenced if subsequent events have put an end to the controversy." *Prudent Publishing Co. v. Myron Mfg. Corp.*, 722 F. Supp. 17, 22 (S.D.N.Y. 1989). For other cases that become moot in the course of litigation, see *Leuer v. Jafco, Inc.*, 375 U.S. 301, 306 n.3 (1964); *Aetna Life Ins. Co. v. Haworth*, 300 U.S. 227, 240-41 (1936); *Stokes v. Village of Wurtsboro*, 818 F.2d 4 (2d Cir. 1987).

The majority holding that a *former* security holder of the issuer who has been divested of his securities by a merger transaction during the pendency of a suit should continue to be qualified to sue is predicated on a perceived necessity to effectuate the statutory policy behind § 16(b). That policy has been described as "to protect the 'outside' stockholders against at least short-swing speculation by insiders with advance information." *Smolowe v. Delendo Corp.*, 136 F.2d 231, 235 (2d Cir.), *cert. denied*, 320 U.S. 751 (1943). This result has been urged on the Court by the SEC in its *amicus curiae* brief and would implement a rule, lately proposed by the SEC but never adopted, designed to invest a *former* stockholder with continued authority to sue. The proposed rule was floated by the SEC in 1988, revised in 1989, as a proposed definition of the term "owner." *See* Ownership Reports and Trading by Officers, Directors and Principal Shareholders, 53 Fed. Reg. 49997 at 50013 (Dec. 13, 1988) ("To preserve Congress' intent, the pro-

posed rules would provide standing to the former public shareholders whose equity securities have been acquired in a business combination or similar corporate transaction over which the individual shareholder has no control."); Ownership Reports and Trading by Officers, Directors and Principal Security Holders, 54 Fed. Reg. 35667 at 35678 (Aug. 29, 1989) ("In response to comment received, the Commission reproposes a more limited definition. The revised proposed definition would extend standing only to former security holders who had filed suit before surrendering their securities.").[2]

The majority of this Court, as well as the SEC, point to the fact that plaintiff is now a shareholder of the parent corporation, Viacom, as further support for the plain extension of the scope of the statute, citing *Blau v. Oppenheim*, 250 F. Supp. 881, 884 (S.D.N.Y. 1966). Reliance on *Blau*, however, is misplaced; it was factually, materially, different. In *Blau*, the issuer was merged out of existence, leading to the argument there made that if a successor was not permitted to sue under § 16(b) no other party would be available to vindicate the policy of the statute. 250 F. Supp. at 886. In the

2 Certainly, the proposed rules do not govern this case, *see Mayer v. Chesapeake Ins. Co.*, 877 F.2d 1154, 1162 (2d Cir. 1989) ("[t]hough the Commission has recently proposed a new rule . . . which would extend § 16(b) liability . . ., thereby changing existing law, . . . the proposed rule does not govern the present case."), *cert. denied*, 58 U.S.L.W. 3427 (1990), although the majority urges that they be given persuasive weight. *See Basic Inc. v. Levinson*, 485 U.S. 224, 239 n.16 (1988) ("The SEC's insights [regarding the materiality standard under Rule 10b-5] are helpful, and we accord them due deference."). In *Piper v. Chris-Craft Indus., Inc.*, 430 U.S. 1, 41 n.27 (1977), the Supreme Court observed, however, that "[the SEC's] presumed 'expertise' in the securities-law field is of limited value when the narrow legal issue is one peculiarly reserved for judicial resolution, namely whether a cause of action should be implied by judicial interpretation in favor of a particular class of litigants."

present case, however, ownership of the issuer passed to Viacom, and Viacom, as the sole shareholder of the issuer, remained in position, if need be, to vindicate the purpose of the statute to pursue recovery of short-swing profits of an insider.

The infirmity of *Blau* is highlighted by a careful study of the facts there presented; these were:

Oppenheim was a director of Van Winkle, a listed company, who engaged in short swing transactions and was thus subject to § 16(b) liability at the instance of security holders of Van Winkle. Plaintiff was not an owner of any security of Van Winkle at any time during its existence. Van Winkle was dissolved in its merger into M & T Chemicals, Inc., and all its assets were transferred to M & T in exchange for stock in American Can Co. Blau thereafter bought stock in American Can which, by then, owned 100% of the stock of M & T. Blau sued Oppenheim as a director of Van Winkle under § 16(b) purporting to act as the "owner of any security of the issuer." The District Judge sustained the claim of Blau, a stockholder of American Can, against Oppenheim for short-swing transactions in stock of Van Winkle on a theory that Van Winkle's assets were now in M & T. However, American Can was the stockholder of M & T, not Blau, but this was passed over by the District Judge. To effectuate the conceived purpose of § 16(b), only American Can should have been accorded status to sue, not Blau. The decision of the District Judge was never reviewed or analyzed by appeal. The public policy arguments pressed in *Blau* could only be made by ignoring the obligatory statutory requirement of stock ownership in the issuer. *Blau* granted standing

to a non-owner, rather than to American Can itself, the sole holder of a security of the successor to Van Winkle.

Blau was mentioned by this Circuit and contrasted with *Untermeyer v. Valhi, Inc.*, 665 F. Supp. 297 (S.D.N.Y. 1987), *aff'd mem.*, 841 F.2d 1117 (2d Cir.), *aff'd on reh'g*, 841 F.2d 25, 25 (2d Cir.) ("In *Blau* the issuer had been merged out of existence. . . . [and] the short swing-profits illegally gained would never have been recovered. In contrast, the issuer here, Sea-Land, survived the merger and remains a viable corporate entity. Because Sea-Land remains a viable corporate entity, it or its shareholder, CSX [the parent], can bring an action under section 16(b) to recover the short-swing profits allegedly gained.") (citations omitted), *cert. denied*, 109 S. Ct. 125 (1988). That comment is directly apposite here.

Two other circuit courts which have addressed this issue have refused to extend the statutory qualification to former shareholders of the issuer either when the issuer remains a viable corporate entity, *see Portnoy*, 607 F.2d at 769 (7th Cir. 1979), or when the issuer was merged out of existence. *See Lewis v. McAdam*, 762 F.2d 800, 804 (9th Cir. 1985) (per curiam) ("We hold that where a corporation is merged out of existence by the wholly owned subsidiary of another corporation, the parent corporation is not an 'issuer' within the meaning of section 16(b). Similarly, a shareholder of the parent corporation cannot be considered an 'owner of any security of the issuer' and accordingly lacks standing to bring a section 16(b) action.").

The SEC itself recognizes that qualifying former shareholders to sue, either judicially or by rule-making,

is a marked departure from the pre-existing jurisprudence under § 16(b). *See* 53 Fed. Reg. at 50013 ("Currently, the plaintiff is required to hold these shares [in the issuer] throughout the legal process.") (citing *Portnoy*, *supra*.); *Id.* ("Where the issuer continues to exist as a wholly-owned subsidiary, . . . the courts have uniformly denied standing to former shareholders and shareholders of the parent.") (citing *Untermeyer*, *infra*; *Lewis*, *supra*; *Portnoy*, *supra*.).

It is a frequently stated principle of statutory construction that when legislation expressly provides a particular remedy or remedies, courts should not expand the coverage of the statute to subsume other remedies. *See National Railroad Passenger Corp. v. National Assoc. of Railroad Passengers*, 414 U.S. 453, 458 (1974). "When a statute limits a thing to be done in a particular mode, it includes the negative of any other mode." *Botany Mills v. United States*, 278 U.S. 282, 289 (1929). In short, the remedies created in § 16(b) are the exclusive means to enforce the obligation imposed by the Act. *Nat'l Railroad Passenger Corp.*, 414 U.S. at 458.

Congress simply has not delegated to the courts the authority to qualify a "former" owner as an "owner of any security of the issuer." While I agree with the statement in *Blau*, 250 F. Supp. at 884, that "[t]he courts, particularly in our circuit, have consistently interpreted section 16(b) in 'the broadest possible' terms in order not to defeat its avowed objective," the case authorities have also taught that: "We have no constitutional authority to rewrite a statute simply because we may determine that it is susceptible of improvement." *Lewis v. McAdam*, 762 F.2d 800, 804 (9th Cir. 1985) (citing

Badaracco v. Commissioner, 464 U.S. 386, 398 (1984)); *see also*, *Badaracco*, 464 U.S. at 401 ("If the result contended for by petitioner is to be the rule, Congress must make it so in clear and unmistakable language."); *TVA v. Hill*, 437 U.S. 153, 194 (1978) ("Our individual appraisal of the wisdom of a particular course consciously selected by the Congress is to be put aside in the process of interpreting the statute."); *Blau v. Lehman*, 368 U.S. 403, 411 (1962) ("Congress is the proper agency to change an interpretation of the [1934] Act unbroken since its passage, if the change is to be made."); *Untermeyer v. Valhi*, 665 F. Supp. 297, 300 (S.D.N.Y. 1987) ("the statutory language may not be strained or distorted to add to the 'prophylactic' effect Congress itself clearly prescribed in § 16(b)"), *aff'd mem.*, 841 F.2d 1117 (2d Cir.), *aff'd on reh'g*, 841 F.2d 25 (2d Cir.), *cert. denied*, 109 S. Ct. 125 (1988).

The statute unambiguously states that "the owner of any security of the issuer" may sue to recover short-swing profits that are recoverable by the issuer under § 16(b). There is simply no indication in any of the legislative history of § 16(b) that the plain meaning of the words "owner of any security of the issuer" was meant to include or even could include one who is no longer the owner of any security of the issuer. Nor is there anything in the legislative history from which to believe "that the plain meaning of the statutory language is inadequate to effect the congressional purpose of providing an enforcement mechanism against insider trading. That a merger may result in a corporation succeeding to an action formerly held by an individual is a consequence dictated by the statute." *Lewis*, 762 F.2d

at 804. Certainly, Congress has had ample opportunity to amend § 16(b) had it so desired.[3]

Further, the narrow private cause of action granted by § 16(b) militates strongly against our attributing to Congress a willingness to allow a more expansive enforcement of the statute. The remedy encompasses not former stockholders of the issuer but only stockholders. As did the Seventh Circuit, we should "reject the plaintiff's invitation to draft 'judicial legislation' to grant him standing." *Portnoy*, 607 F.2d at 768.

Accordingly, I would affirm the order and judgment appealed from.

3 Several times in the past decade or so Congress has legislated amendments to the 1934 Act. *See e.g.*, Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 98-376, 98 Stat. 1265 (1988); Shareholder Communications Act of 1985, Pub. L. No. 99-222, 99 Stat. 1737 (1985); Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264 (1984); Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, 91 Stat. 1494 (1977); Domestic & Foreign Investment Improved Disclosure Act of 1977, Pub. L. No. 95-213, 91 Stat. 1498 (1977).

APPENDIX B

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

87 Civ. 0085 (MBM)

IRA L. MENDELL, in behalf of Viacom, Incorporated, and, alternatively, Viacom International, Incorporated,

Plaintiff,

—against—

KEITH R. GOLLUST, PAUL E. TIERNEY, JR., AUGUSTUS K. OLIVER, GOLLUST, TIERNEY AND OLIVER, GOLLUST & TIERNEY, INCORPORATED, CONISTON PARTNERS, CONISTON INSTITUTIONAL INVESTORS, BAKER STREET PARTNERS, WJB ASSOCIATES, HELSTON INVESTMENT INCORPORATED, VIACOM INCORPORATED, AND VIACOM INTERNATIONAL, INCORPORATED

Defendants.

OPINION AND ORDER

APPEARANCES

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Attorneys for Defendants other than Viacom Incorporated, and Viacom International, Incorporated

MICHAEL B. MUKASEY, U.S.D.J.

Plaintiff Ira L. Mendell, as owner of stock in Viacom, Inc. (Viacom), sues to recover allegedly illegal profits made when the common stock of Viacom International, Inc. (International), a wholly-owned subsidiary of Viacom, was improperly traded by defendants Keith R. Gollust, Paul E. Tierney, Jr., Augustus K. Oliver, Gollust, Tierney and Oliver, Gollust & Tierney, Inc., Coniston Partners, Coniston Institutional Investors, Baker Street Partners, WJB Associates, and Helston Investment, Inc. (collectively referred to as defendants). Plaintiff alleges that defendants violated § 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b) (1982), and he seeks disgorgement of the allegedly ill-gotten gains. Defendants move for summary judgment on plaintiff's securities law action, claiming that plaintiff lacks standing to sue under § 16(b). Fed R. Civ. P. 56. Because, as a matter of law, plaintiff does not have standing to prosecute his § 16(b) claim against defendants, their motion is granted.

During 1986, defendants collectively owned more than 10% of International's common stock, making them "principal stockholders" in International. 15 U.S.C. § 78p(a) (1982). As principal stockholders, their purchases and sales of International securities were subject to certain restrictions. 15 U.S.C. § 78p(b) (1982). For example, under § 16(b), if during any six month period, defendants bought International stock for less than they sold it, they would be liable to International for the difference. Alternatively, if International did not sue, one of International's shareholders could sue on behalf of the corporation. 15 U.S.C. § 78p(b) (1982). Plaintiff alleges that in four months, from July to October 1977, defendants made approximately $11,000,000 in allegedly illegal profits from trades in International common stock, and he seeks return of that money to International.

Although plaintiff owned International securities when the allegedly illegal trades occurred, he does not own International securities now. In 1987, plaintiff sold his stake in International to Arsenal Acquiring Corp., which bought out International stockholders for a combination of cash and

stock in Arsenal's parent corporation, known then as Arsenal Holdings, Inc. When Arsenal Acquiring Corp. held over 50% of International's voting securities, it merged itself into International. At the conclusion of that merger, International was a wholly owned subsidiary of Arsenal Holdings, Inc. Shortly thereafter, Arsenal Holdings, Inc. changed its name to Viacom, and plaintiff's shares in Arsenal Holdings, Inc. became Viacom shares.

Defendants assert that plaintiff cannot prosecute this action because he does not own International securities any longer. Defendants are correct. Suits to disgorge ill-gotten gains under § 16(b) may be prosecuted only by the issuer itself or the holders of its securities. *Untermeyer* v. *Valhi, Inc.*, 841 F.2d 25 (2d Cir.) (per curiam), *cert. denied*, 109 S. Ct. 175 (1988); 15 U.S.C. § 78p(b) (1982). *See Herrmann* v. *Steinberg*, 812 F.2d 63, 67 n.4 (2d Cir. 1987); *Rothenberg* v. *United Brands Co.*, [1977-1978] Fed. Sec. L. Rep. (CCH) ¶ 96,045 at 91,691 (S.D.N.Y.), *aff'd mem.*, 573 F.2d 1295 (2d Cir. 1977). Therefore, because plaintiff no longer owns any International securities, he may not sue under § 16(b) to recover any allegedly illegal profits made by defendants in their trades of International securities.

Moreover, in this case, plaintiff's status as a stockholder of Viacom, International's sole shareholder, does not confer upon him standing to sue on Viacom's behalf. Illegal profits made through trading an issuer's securities are recoverable by the issuer's parent or holders of the parent's securities, but only when the issuer is no longer a viable corporate entity. *Blau* v. *Oppenheim*, 250 F. Supp. 881, 886 (S.D.N.Y. 1966). In those cases, the defunct corporation must rely on its successor to vindicate its rights under § 16(b). *Untermeyer*, 841 F.2d at 25, *citing Blau*, 250 F. Supp. at 886. In contrast, where the issuer remains a viable corporate entity at the time of the suit, the issuer or holders of its securities are still capable of suing under § 16(b), and there is no need to rely on the parent or its securities holders to vindicate the issuer's rights. Therefore, in this case, if International is a viable corporate entity, only it and its stockholders may sue defendants under § 16(b). *Untermeyer*, 841 F.2d at 25.

International is a viable corporate entity. It has survived its merger with Arsenal Acquiring Corp., and it continues to have a shareholder, Viacom. Therefore only International or the sole holder of its securities, Viacom, may sue defendants under § 16(b). *Untermeyer*, 841 F.2d at 25. Because plaintiff is neither International nor Viacom, he does not have standing to sue defendants under § 16(b).

In addition, plaintiff cannot meet his standing burden by asserting that he sues derivatively on behalf of Viacom, which in turn sues derivatively on behalf of its subsidiary International, which allegedly has a § 16(b) cause of action against defendants. Section 16(b)'s standing requirements are specific, and must be strictly construed. *See Foremost-McKesson, Inc.* v. *Provident Sec. Co.*, 423 U.S. 232, 251-52 (1976). If successful, plaintiff would enlarge the class of persons entitled to sue under § 16(b) to include shareholders of a shareholder. However, shareholders of a shareholder are not the issuer or the owners of the issuer's securities, and therefore, by the statute's own terms, they are not entitled to sue under § 16(b). Accordingly, the fact that plaintiff calls his suit a "double derivative" action on behalf of International fails to give plaintiff standing.

As a final matter, because this suit is brought on behalf of International and Viacom, and those corporations are mere nominal defendants in this action, summary judgment for defendants disposes entirely of plaintiff's claims and requires dismissal of this action as to International and Viacom.

So Ordered:

/s/ Michael B. Mukasey
Michael B. Mukasey
U.S. District Judge

Dated: November 8, 1988

APPENDIX C

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

87 CIVIL 0085 MBM
Filed January 17, 1989

IRA L. MENDELL, in behalf of Viacom, Incorporated, et ano

Plaintiff

—against—

KEITH R. GOLLUST, PAUL E. TIERNEY, JR., ET AL

Defendants

JUDGMENT

Defendants having moved for summary judgment and the said motion having come before the Honorable Michael B. Mukasey, U.S.D.J., and the Court thereafter on November 9, 1988, having handed down its opinion and order (#63376), granting defendants' motion, it is,

ORDERED, ADJUDGED AND DECREED: That the complaint be and it is hereby dismissed.

/s/ RAYMOND F. BURGHARDT
Clerk

DATED: New York, N.Y.
January 17, 1989

THIS DOCUMENT WAS ENTERED ON THE DOCKET ON ________.

APPENDIX D

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

87 Civ. 0085 (MBM)

IRA L. MENDELL, in behalf of Viacom, Incorporated, and, alternatively, Viacom International, Incorporated,

Plaintiff,

—against—

KEITH R. GOLLUST, PAUL E. TIERNEY, JR., AUGUSTUS K. OLIVER, GOLLUST, TIERNEY AND OLIVER, GOLLUST & TIERNEY, INCORPORATED, CONISTON PARTNERS, CONISTON INSTITUTIONAL INVESTORS, BAKER STREET PARTNERS, WJB ASSOCIATES, HELTON INVESTMENT, INCORPORATED, VIACOM INCORPORATED, AND VIACOM INTERNATIONAL, INCORPORATED,

Defendants.

OPINION AND ORDER

APPEARANCES:

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Viacom, Inc.

MICHAEL B. MUKASEY, U.S.D.J.

In a prior Opinion and Order, I dismissed the securities-law action of plaintiff Ira L. Mendell, brought on behalf of Viacom, Inc. (Viacom), and Viacom International, Inc. (International), against defendants Keith R. Gollust, Paul E. Tierney, Jr., Augustus K. Oliver, Gollust, Tierney and Oliver, Gollust & Tierney, Inc., Coniston Partners, Coniston Institutional Investors, Baker Street Partners, WJB Associates, Helton Investment, Inc., Viacom, and International. *Mendell* v. *Gollust*, No. 87 Civ. 0085 (MBM) (S.D.N.Y. Nov. 8, 1988). Mendell now seeks relief from that Order, and the judgment of dismissal. Fed. R. Civ. P. 60(b). For the reasons discussed below, Mendell's motion is denied.

In his original suit, Mendell claimed that defendants violated § 16(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78p(b) (1982) allegedly by making illegal trades in International common stock. However, Mendell did not have standing to sue defendants because he did not own International securities. Slip. op. at 3-5. On January 9, 1989, Mendell bought approximately $1000.00 worth of International securities which were issued in June or July of 1988. Affidavit of Irving Malchman Exhibit C. The judgment dismissing the action then was issued on January 17, 1989.

Mendell asserts that his belated purchase of International securities gives him standing to sue defendants, and therefore he seeks to have the dismissal of his earlier claim vacated. Mendell asserts that he suffered dismissal because of a technical defect in his prior suit, and that with the correction of

that defect, he should now be permitted to pursue his claim. Mendell's position is without merit.

Rule 60(b) provides in relevant part that "upon such terms as are just, the court may relieve a party . . . from a final judgment [or order] . . . for the following reasons: (1) mistake, inadvertence, surprise, or excusable neglect; . . . (6) any other reason justifying relief from the operation of the judgment."

Mendell appears to argue, although not explicitly, that dismissal of his claim was a result of "mistake, inadvertence, surprise, or excusable neglect." Fed. R. Civ. P. 60(b)(1). Specifically, Mendell argues that he bought an International security "as soon as it occurred to plaintiff's counsel (1) that any security holder of International could maintain a 16(b) action here and (2) that notes of International were available to be purchased." Reply Memorandum in Support of Plaintiff's Motion for an Order Pursuant to [Fed. R. Civ. P.] 60(b) Relieving Plaintiff of Court's Order and Judgment of Dismissal at 4. In a footnote, Mendell explains that "[i]f asked, plaintiff's counsel would have answered, after a little research, that any security holder can maintain a 16(b) action. Thinking of it in the first instance is something else, however." *Id.* at n.1. Counsel's ignorance of the law cannot form the basis for an order under Fed. R. Civ. P. 60(b)(1). *E.g.*, *Nemaizer* v. *Baker*, 793 F.2d 58, 62-63 (2d Cir. 1986). Therefore, Mendell's motion cannot be granted under Fed. R. Civ. P. 60(b)(1).

Mendell seeks to vacate his dismissal also under Fed. R. Civ. P. 60(b)(6). Unlike Fed. R. Civ. P. 60(b)(1), this subsection "does not particularize the factors that justify relief, but . . . provides courts with authority '. . . to vacate judgments whenever such action is appropriate to accomplish justice,' *Klapprott* v. *United States*, 335 U.S. 601, 614-15 (1949), while also cautioning that it should only be applied in 'extraordinary circumstances,' *Ackermann* v. *United States*, 340 U.S. 193[, 199] (1950)." *Liljeberg* v. *Health Servs. Acquisition Corp.*, 108 S. Ct. 2194, 2204 (1988); *Matarese* v. *LeFevre*, 801 F.2d 98, 106 (2d Cir. 1986) (motion should be granted when its denial would work an "extreme and undue

hardship"), *cert. denied*, 480 U.S. 908 (1987). Mendell's argument is that as a noteholder of International, he now has standing to maintain his claim against defendants. When compared with the jailed, penniless, physically ill petitioner in *Klapprott* who defaulted despite his best efforts to avoid that result, or the petitioner confronting the appearance of grave judicial impropriety in *Health Servs. Acquisition Corp.*, Mendell is not the victim of "extraordinary circumstances" such that he will suffer "extreme and undue hardship" if relief is denied. His new basis for standing arises from an after-the-fact strategem devised following an adverse opinion, and is intended to make it appear that he, in common with others, has suffered cognizable injury. Therefore, Mendell's position is much closer to that of the petitioner in *Ackermann*, who had the merits of his case heard, and whose rights were extinguished because he made a counselled, "voluntary, deliberate, free, [and] untrammeled choice," 340 U.S. at 200, that ended up being a tactical error.

Mendell has failed to meet the applicable legal standards for vacating my earlier Order dismissing his claim. Accordingly, his motion for relief from that Order and the judgment dismissing his action is denied.

So Ordered:

/s/ Michael B. Mukasey
Michael B. Mukasey
U.S. District Judge

Dated: May 23, 1989
New York, New York

APPENDIX E

UNITED STATES DISTRICT COURT
Southern District of New York

Civil Action No.
87 Civ. 0085 (MBM)

Ira L. Mendell, in behalf of Viacom, Inc. and, alternatively, Viacom International, Inc.

Plaintiff,

vs.

Keith R. Gollust, Paul E. Tierney, Jr., Augustus K. Oliver, Gollust Tierney and Oliver, Gollust & Tierney, Inc., Coniston Partners, Coniston Institutional Investors, Baker Street Partners, WJB Associates, Helston Investment Inc., Viacom Inc., and Viacom International, Inc.

Defendants.

AMENDED COMPLAINT
JURY TRIAL DEMANDED

First Claim for Relief

(Single Derivative Action on Behalf of New Viacom)

Plaintiff for his amended complaint alleges upon information and belief, except as to those allegations which pertain to the plaintiff, as follows:

1. Plaintiff brings this First Claim in behalf of and for the benefit of Viacom, Inc. ("new Viacom") against the other defendants herein for violation of Sections 16(b) and 20 of the Securities Exchange Act of 1934 ("Exchange Act").

2. This Court has jurisdiction of this action pursuant to Section 27 of the Exchange Act.

3. Many of the acts and transactions constituting the violations of law complained of occurred in this District and the

principal executive office of Viacom International, Inc. ("old Viacom") is located herein.

4. (a) As the result of a corporate restructuring that occurred on or about June 3, 1987 ("restructuring"), old Viacom became the wholly owned subsidiary of new Viacom.

(b) As a result of the restructing [*sic*], the shareholders of old Viacom received 17% of the common stock of new Viacom, 17% of the preferred stock of new Viacom (both the common and preferred stock of new Viacom are listed and traded on the American Stock Exchange), and cash.

(c) Prior to the restructuring, new Viacom was a shell corporation incorporated in Deleware [*sic*] for the purpose of acquiring old Viacom. The only significant asset of new Viacom is old Viacom.

5. Section 16(b) of the Exchange Act provides *inter alia*, that the issuer may recover from the beneficial owner of more than ten per centum of any equity security of the issuer any profit realized from any purchase or sale, or any sale and purchase, of any equity security of the issuer within any period of less than six months.

6. For the purposes of Section 16(b), all defendants (except old and new Viacom) constituted a single or one beneficial owner of more than ten per centum of the common stock of old Viacom.

7. At all times referred to herein, the common stock of old Viacom was listed and traded on the New York Stock Exchange, a national securities exchange, and was subject to and regulated by Section 16(b) of the Exchange Act.

8. Old Viacom was a corporation organized and existing under the laws of the State of Ohio.

9. Prior to the restructuring, plaintiff Ira L. Mendell owned 1,200 shares of the common stock of old Viacom continuously at all times material to the bringing of this action As a result of the restructuring, plaintiff is now a stockholder of new Viacom.

10. Defendant Coniston Partners is a New Jersey limited partnership ("Coniston I"). The address of Coniston I is 330 Hobart Avenue, Short Hills, NJ 07078 and its principal business is that of investment partnership. Coniston I has five general partners as follows:

(a) General Partner: A general partnership defendant Gollust, Tierney and Oliver ("GTO"), 500 Park Avenue, New York, New York 10022.

The principal business of GTO is that of investment banking.

The general partners of GTO are:

(i) Defendant Keith R. Gollust, 500 Park Avenue, New York, NY 10022

(ii) Defendant Paul E. Tierney, Jr., 500 Park Avenue, New York, NY 10022

(iii) Defendant Augustus K. Oliver, 500 Park Avenue, New York, NY 10022

(iv) Defendant Gollust & Tierney, Inc., a New Jersey corporation ("G&T")

(b) General Partner: defendant G & T. The address of G & T is 330 Hobart Avenue Short Hills, NJ 07078.

The principal business of defendant G & T is that of investment banking.

Executive officers and directors of G & T are:

(i) Defendant Keith R. Gollust, Managing Director

(ii) Defendant Augustus K. Oliver, Managing Director

(c) General Partner: defendant Keith R. Gollust

(d) General Partner: defendant Paul E. Tierney, Jr.

(e) General Partner: defendant Augustus K. Oliver

11. Defendant, Coniston Institutional Investors, is a New Jersey limited partnership ("Coniston II"). Coniston II has one general partner, namely defendant GTO. The address of

Coniston II is 330 Hobart Avenue, Short Hills, NJ 07078 and its principal business is that of investment partnership.

12. Defendant Baker Street Partners is a New Jersey limited partnership ("Baker"). Baker has one general partner, namely defendant GTO. The address of Baker is 330 Hobart Avenue, Short Hills, NJ 07078 and its principal business is that of an investment partnership.

13. Defendant WJB Associates, is a Bahamian partnership ("WJB"). WJB has one general partner, namely defendant GTO. Its principal business is that of investment partnership.

14. Defendant Helston Investment Inc. is a Panamanian corporation ("Helston") for which defendant G & T serves as investment manager. Defendant Gollust is an officer and director of Helston. Helston is also a wholly-owned subsidiary of and under the control of Coniston International Corporation, a Panamanian corporation of which defendants Oliver, Tierney and Gollust are directors.

15. In connection with all the transactions alleged in this complaint, the defendants, except old and new Viacom ("Coniston defendants"), operated as a single unit and as a single beneficial owner within the meaning of Section 16(b) and made their official filings with the Securities and Exchange Commission ("SEC") as a unit, and through the identical agent and representative and attorney in fact and in a single document and made all their short-swing purchases and sales in conformity with and pursuant to identical advice, information, management and direction. They have referred to themselves collectively as "Coniston Partners" in filings with the SEC and in releases to the press and to the financial community, both in the transactions alleged herein and in other similar transactions and dealings.

16. The Coniston defendants purchased and sold the common stock of old Viacom as herein alleged on a unitary basis under and pursuant to the advice, direction and management of defendants Gollust, Tierney and Oliver as a firm (defendant GTO), as a corporation (defendant G&T) and as individuals.

17. The Coniston defendants, while a ten per centum beneficial owner of old Viacom's common stock, purchased approximately 700,000 shares of old Viacom's common stock between in or about July, 1986 and September, 1986 at prices ranging from approximately $27 per share to no more than $40 per share.

18. In October, 1986 the Coniston defendants, while a ten per centum beneficial owner of old Viacom's common stock, sold approximately 700,000 shares of old Viacom's common stock for approximately $43 per share plus a price protection clause which would permit the Coniston defendants to benefit further and make additional profits should the purchaser or purchasers of said 700,000 shares from the Coniston defendants sell said shares at a higher price and under certain other circumstances. Said sale was made by the Coniston defendants in a single sales agreement to a single purchaser and was made under the advice, management and direction of Gollust, Tierney and Oliver as a firm (defendant GTO), as a corporation (defendant G&T) and as individuals.

19. By reason of their purchase and sale of old Viacom's common stock within a period of less than six months and while a ten per centum beneficial owner of old Viacom's common stock, the Coniston defendants realized short term profits in violation of Section 16(b) in the amount of approximately $11,000,000.

20. By virtue of the restructuring, old Viacom has become new Viacom's subsidiary so that new Viacom is now the issuer within the meaning of Section 16(b).

21. On or about July 10, 1987 a demand was made upon both old and new Viacom and their Boards of Directors to institute and prosecute an action against the Coniston defendants pursuant to Section 16(b) for the acts and transactions alleged herein, but they have failed to bring such action.

22. This is not a collusive action to confer upon a court of the United States jurisdiction of an action which it would not otherwise have.

ALTERNATIVE SECOND CLAIM FOR RELIEF

(Double Derivative Action On Behalf of Old Viacom)

23. Plaintiff repeats and realleges the facts set forth in the First Claim for Relief.

24. This Second Claim for Relief is brought, alternatively to the First Claim, as a double-derivative action on behalf of old Viacom.

WHEREFORE, plaintiff demands judgment in behalf of new Viacom upon the First Claim for Relief or, alternatively, in behalf of old Viacom upon the Second Claim for Relief, awarding damages in the approximate amount of $11,000,000 against the Coniston defendants, and each of them, jointly and severally, for said short-swing profits made by said Coniston defendants in the purchase and sale of old Viacom's common stock; and awarding plaintiff the costs of this suit, including reasonable attorneys', accountants' and experts' fees and other disbursements, together with such further relief as the Court may deem appropriate.

JURY DEMAND

Plaintiff respectfully demands a trial by jury.

Dated: New York, New York
March 11, 1988

KAUFMAN MALCHMAN KAUFMANN
& KIRBY

By: /s/ IRVING MALCHMAN
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